Commonwealth of Massachusetts
Appeals Court

2015-P-0287

GENENTECH, INC.,

Plaintiff-Appellant,

vs.

COMMISSIONER OF REVENUE,

Defendant-Appellee.

Appeal from the Decision of the Appellate Tax Board

BRIEF FOR THE PLAINTIFF-APPELLANT

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COMMONWEALTH OF MASSACHUSETTS
APPEALS COURT

GENENTECH, INC.,
Appellant,

vs.

COMMISSIONER OF REVENUE,
Appellee.

Docket No. 15-P-0287

GENENTECH, INC.'S CORPORATE DISCLOSURE STATEMENT

Appellant, Genentech, Inc. hereby submits the following corporate disclosure as described in Rule 1:21 of the Rules of the Supreme Judicial Court:

Genentech, Inc. is 100% owned by Roche Holdings, Inc., which is not a publically traded corporation. Roche Holdings, Inc. is 100% owned by Roche Finance Limited, which is not a publically traded corporation. Roche Finance Limited is 100% owned by Roche Holding Limited, which is a Swiss company that is publically traded on a foreign stock exchange.

Respectfully Submitted,

GENENTECH, INC.

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Dated: May 11, 2015

CERTIFICATE OF SERVICE

I certify that on May 11, 2015, I caused to be served a true and accurate copy of this Corporate Disclosure Statement as described in Rule 1:21 of the Rules of the Supreme Judicial Court by mail and email upon the following counsel:

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STATEMENT OF ISSUES

1. Did the Appellate Tax Board (the "Board") err when it held that Genentech, Inc. ("Genentech") was a manufacturer as defined by G.L. c. 63, § 38(1) for purposes of apportionment under the Corporate Excise Tax (the "CET")?
2. Did the Board err in holding that Genentech was engaged "in substantial part" in manufacturing?
3. If Genentech is required to apportion its income as a manufacturer but not granted credits available to manufacturers, is the Massachusetts CET scheme unconstitutional as applied to Genentech?

STATEMENT OF THE CASE

Nature of the Case

This is an appeal from a decision of the Board upholding the Commissioner of Revenue's (the "Commissioner") denial of Genentech's requests for abatement of CET, interest, and penalty for the tax years ended 1998 through 2004 (the "Years at Issue").

The main issue in this appeal is whether Genentech is a "manufacturer" that is engaged in "substantial part" in manufacturing activities under the CET statutes. If it is, the applicable statute

provides that Genentech must compute its net income attributable to Massachusetts (i.e., "apportion" its net income) using a special statutory apportionment formula applicable to manufacturers, i.e., single sales factor apportionment. If Genentech is deemed to be a manufacturer that is substantially engaged in manufacturing activities, this Court must then decide whether the Massachusetts tax scheme is unconstitutional as applied to Genentech.

Prior Proceedings and Disposition Below

The issues for this appeal are the same for all of the Years at Issue.

Departmental Proceeding for 1998-2001

For tax years ended December 31, 1998 through December 31, 2001, Genentech filed its CET returns using the three-factor apportionment formula applicable to general business corporations. A456.[1]

The Commissioner audited and then issued three Notices of Assessment for this period. A458. The first, dated July 6, 2005, assessed additional CET in the total amount of $1,125,764, including interest and

[1] All references to "A" are to the Record Appendix, to "EA" are to the Exhibits to the Record Appendix, and all references to "_T" are to the hearing Transcripts submitted herewith dated April 25 and 26, 2013 ("_" for the transcript volume).

penalties, for the tax years ended June 30, 1999, October 26, 1999, December 31, 1999, December 31, 2000, and December 31, 2001. A458. The second, dated July 11, 2005, assessed an additional amount in CET of $61,673.95, including interest and penalties for the tax year ended December 31, 1998. A458. The third, dated September 17, 2005, assessed an additional amount of $49,244.08, including interest and penalties for the tax year ended December 31, 1999. A458-459.

Genentech filed an Application for Abatement, dated September 27, 2005, for all amounts assessed by the Commissioner for the tax years ended December 31, 1998 through December 31, 2001. A459. The Commissioner denied the Application for Abatement on January 17, 2006. A459. On March 16, 2006, Genentech timely filed a Petition Under Formal Procedure with the Board. A459.

Departmental Proceeding For 2002-2004

For tax years ended December 31, 2002, and December 31, 2003, Genentech filed its CET returns using the three-factor apportionment formula applicable to general business corporations. A456.

For the tax year ended December 31, 2004, Genentech originally filed its CET return using the

single sales factor apportionment formula applicable to manufacturers, but subsequently filed an Application for Abatement claiming that it was not substantially engaged in manufacturing and thus should have been entitled to apportion its income on the standard three-factor basis. A456.

On February 7, 2007, the Commissioner issued a Notice of Assessment of additional CET for the tax years ended December 31, 2002 through December 31, 2004 in the amount of $2,027,746, including interest and penalties. A459.

On March 9, 2007, Genentech timely filed an Application for Abatement. A459. The Commissioner denied the Application for Abatement on June 11, 2007 with respect to the 2002 and 2003 tax years, but took no express action on Genentech's claim with respect to the 2004 tax year. A459. On August 10, 2007, Genentech timely filed a Petition Under Formal Procedure with the Board appealing the Commissioner's refusal to abate the assessed amounts for 2002 through 2004. A459-460.

On March 1, 2008, Genentech filed a second Application for Abatement for the tax year ended December 31, 2004. A460. The Commissioner denied the

application on June 6, 2008. A460. On August 1, 2008, Genentech timely filed a Petition Under Formal Procedure appealing the Commissioner's refusal to abate additional CET assessed for the 2004 tax year. A460. Also on March 1, 2008, Genentech filed a second Application for Abatement raising other issues. A460. By letter dated October 24, 2008, Genentech withdrew its consent for the Commissioner to act on this second Application for Abatement and later filed a second Petition Under Formal Procedure with the Board on December 22, 2008. A460.

Board Proceedings for All Years at Issue

The Board entertained a Motion for Summary Judgment by Genentech and a Motion for Partial Summary Judgment by the Commissioner. A460-461. On January 23, 2013, the Board issued an order denying Genentech's Motion for Summary Judgment and allowing in part the Commissioner's Motion for Partial Summary Judgment. A304.

On April 25 and 26, 2013, the Board conducted a hearing with respect to whether Genentech conducted "substantial manufacturing." 1T; 2T. On October 24, 2013, the Board issued its Corrected Decision for the Commissioner. A452.

On November 17, 2014, the Board issued its Findings of Fact and Report. A453-514. In sum, the Board held that Genentech was a manufacturer, that it engaged in "substantial" manufacturing, and that the investment tax credit and research and development credit regimes are not unconstitutional.[2] A453-514.

Genentech timely filed a Notice of Appeal on January 13, 2015. This case was docketed in this Court on March 3, 2015 upon the timely submission by Genentech of its filing fee with respect to this appeal.

STATEMENT OF THE FACTS

Genentech does not dispute the Board's description of the facts. The following sets forth the facts relevant to the issues appealed.[3]

Genentech is a biotechnology company that develops drugs produced by living cells. A455. Through an organic process, the cells are genetically modified and produce a protein with a desired

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[2] The Board also found that Genentech was not protected from imposition of the CET by a federal statute, P.L. 86-272. That issue is not being appealed.

[3] Inasmuch as Genentech does not dispute the Board's findings and holdings as they relate to P.L. 86-272, facts solely related to that issue are omitted.

pharmacologic effect, called a "protein of interest." A473. With one limited exception not applicable here, all of Genentech's drug production activities took place outside of Massachusetts.[4] A473.

The proteins that form the basis for Genentech's drugs result from a natural process, which is unlike traditional pharmaceutical companies that combine chemical compounds to make a new product. A473-474. That process entails a deoxyribonucleic acid ("DNA") sequence that transforms a cell's genetic code. A473-474. The transformed cell then produces the protein of interest. A474.

Simple biotechnology drug compounds such as insulin and hGH are produced using E. coli. A474. More complex drugs such as Avastin®, a Genentech treatment for cancer, are produced using Chinese hamster ovary cells. A474. The cell then grows and reproduces, with each cell copy carrying the genetic modification that instructs it to produce the protein. A474.

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[4] As noted by the Board, Genentech participated in a relatively minor collaboration with Alkermes Controlled Therapeutics, Inc. in Massachusetts during the Years at Issue.

The Board found that there are four stages of Genentech's drug production process: (1) alteration of the DNA or genetic code of a living cell to instruct it to produce the protein of interest; (2) production of the desired protein by genetically altered cells; (3) purification of the desired protein; and (4) formulation and packaging of the resulting bulk drug for sale to the public. A473.

Genentech developed the technology to synthetically mass produce the proteins. A474. The DNA sequence is inserted by the use of polyethylene glycol, which alters cell membrane permeability. A474. Genentech acclimatizes the cells in larger and larger tanks, ranging in size up to 25,000L for 3 days to 2 weeks, to continue their growth. A474. The cells are fed glucose and other nutrients and Genentech employees monitor their environment. A474.

Once the proteins have been expressed, they are purified by separating and isolating them from the mix of cells and other material present. A474. Proteins that are not directly expressed into the solution are extracted by "disrupting" or breaking down the cell walls containing them. A474-475. The filtration processes used by Genentech typically include

ultrafiltration, where the solution is passed through the microscopic pores of a membrane acting as a sieve to separate material by size, and chromatography, where solution is passed through a column to fully separate the protein from any other unwanted solution components. A475.

Three common types of chromatography processes are used: affinity, size exclusion, and ion exchange chromatography. A475. In affinity chromatography, antibodies introduced into the column bind to the desired protein to help extract it. A475. Size exclusion chromatography filters based on the size of the protein. A475. Ion exchange chromatography separates based on differences in electrical charges of the protein and other components. A475. At the end of the purification process, the desired protein has been isolated from other proteins and contaminants and is placed in a solution suitable for the next process step, typically frozen storage or final formulation. A153; Undisputed Material Facts #25. This bulk drug substance is delivered to other facilities where it is formulated, filled into its final dosage form, and labeled and packaged for individual patient use. A475. The packaged drug is

delivered to distributors or directly to physicians, hospitals, and pharmacies around the world. A475.

The statutory test for determining whether a taxpayer is engaged in "substantial part" in manufacturing involves three ratios that compare a taxpayer's manufacturing activities to its total activities. G.L. c. 63, § 38(l). The three ratios are the taxpayer's property, payroll, and sales. The parties agreed that the property and payroll ratios are not met for the Years at Issue. A476. Thus the Board ruled only on the receipts ratio. A511-512.

Genentech's Treasurer, Van Bui, testified at the trial regarding Genentech's treasury activities. 1T23. Ms. Bui is an actuary and a certified charter financial analyst. 1T24. She testified that she was primarily responsible for Genentech's cash management. 1T24. Genentech's treasury department managed the investment of cash in short-term securities. A477. In all, eleven Genentech accounts held short-term assets at Mellon Bank ("Mellon Accounts"), which held money market funds, commercial paper, and treasury bonds. A477.

Money market funds are pooled investment vehicles that aim to maintain a consistent net asset value

("NAV") of $1 per share, which is different from the aims of other types of investments. A477. Unlike shares of other equity investments, investors generally expect that their shares of money market funds may be redeemed for the amount originally invested and that earnings will come from interest or dividends. A477. Consistent with expectations, the money market funds held in the Mellon Accounts maintained a $1 NAV, which allowed Genentech to redeem shares for the purchase price with no gain or loss. A478.

Commercial paper is a short-term debt instrument that is usually issued by a corporation in order to meet working capital needs as an alternative to a bank loan. A478.

Ms. Bui testified that Genentech's treasury department assessed the company's cash needs daily and would accordingly liquidate investments to free up cash or invest excess cash into short-term securities, as necessary. A478. The receipts recorded in the Mellon Accounts included dividends, interest, and return of capital through the redemption or maturity of securities. A478.

The Board found that "[t]he redemption and maturity of the short-term securities resulted in gross proceeds." A479 (emphasis added). The Board gave the example of Genentech using $100 of excess cash to purchase 100 shares of a money market fund. A479. Over the course of 30 days, Genentech earned $2 in interest, but when a need arose for $100 to be used in the business, Genentech redeemed its 100 shares for $100 in cash. A479. The parties disagree as to whether the receipts that the Board called "gross proceeds" are in fact "gross receipts" for purposes of determining the percentage of Genentech's receipts that were derived from manufacturing. A479. The Board incorrectly determined that Genentech should be able to claim gross receipts of $2, instead of $102 (comprised of the $2 in interest plus the $100 return of capital which Genentech had originally invested and then redeemed). A479, A511-512. Due to the large volume of transactions involved, which occurred almost daily, the Board's legal determination means the difference between whether Genentech satisfied the receipts test or not. A479, A511-512.

Ms. Bui testified that during the Years at Issue, Genentech retained Mellon Bank to act as its "book of

record" to assist Genentech in tracking its large daily securities investments. 1T30. Genentech reported its daily trading to Mellon Bank, which maintained the records of these securities trades on behalf of Genentech's treasury department. 1T30. Mellon Bank maintained this information on its computers in the regular course of its business, and it regularly reported to Genentech the gross receipts derived from the investments and other information. 1T29-30; 1T49-50.

Ms. Bui testified that Genentech relied upon these Mellon Bank reports for financial reporting purposes and that she regularly called Mellon Bank and accessed this database on a monthly, if not weekly, basis. 1T25-26. She further testified that the information provided in Mellon's transaction detail report contained in various exhibits was an accurate reflection of Mellon Bank's contemporaneously established database, and was available online to Ms. Bui and others at Genentech during the Years at Issue. 1T31, 33. Genentech checked this information every day during the Years at Issue for reasonableness. 1T32, 34. Ms. Bui verified that these Mellon Bank reports contained an accurate representation of

Genentech's gross receipts from investments. 1T40, 81.

At trial, Louis Dombrowski, Genentech's Associate Tax Director, who is a Certified Public Accountant holding a master's degree in taxation, testified regarding the calculation of the gross receipts ratio. 1T125-216. Mr. Dombrowski relied upon gross receipts data furnished by Mellon Bank from the computerized database described above reflecting Genentech's investment trading activity. See 1T129. He computed the percentages of manufacturing receipts over total gross receipts. 1T144-150. He used multiple methods to compute the percentages, including at least one method that accounted for concerns raised by the Commissioner. 1T144-150. The varying methods produced a range of receipts attributable to sales of drugs, as set forth in the following chart. 1T150; EA4705-4710.

Year	Percentage of Drug Sales/Gross Receipts
1998	3.5863%-3.8551%
1999	3.9640%-4.3554%
2000	7.3183%-8.2843%
2001	5.2709%-5.6389%
2002	6.5598%-7.0604%
2003	8.5504%-10.1656%
2004	8.1971%-9.2854%

SUMMARY OF ARGUMENT

When the Massachusetts legislators enacted a single sales factor apportionment scheme for manufacturers in 1995, it was clear that the change would have two consequences: (1) to decrease CET liability for in-state manufacturers and (2) to increase CET liability for out-of-state manufacturers. The Massachusetts Department of Revenue explained this during the legislative process. Before the change, manufacturers and other general business corporations used an apportionment formula based on property, payroll, and sales located or made in Massachusetts. A change to single sales factor apportionment would mean that manufacturers would no longer base their CET liability on the amount of property they owned or rented, or the personnel they employed in Massachusetts. The hope was that companies would not be discouraged from locating manufacturing plants in the state if the measure of their tax was not based on property and payroll within the state. The Commissioner's treatment of a biotech company that harvests proteins from living cells as a "manufacturer" is beyond that contemplated by the

legislature in defining that term within the new apportionment scheme.

Genentech's activities do not constitute "manufacturing" as that term was defined by the Massachusetts legislature. See infra pages 18-24. Genentech's biotech drugs are naturally occurring proteins that are produced by living cells. They are not manufactured by hand or machinery. Instead, they are harvested by separating them from the cell and are subsequently sold for human use without alteration. Genentech's activities are akin to mining or breeding, which the Massachusetts courts have repetitively held do not constitute "manufacturing."

Even if Genentech is deemed to be a "manufacturer," it still is not required to measure its income based on a single sales factor because it is not engaged in "substantial part" in manufacturing as defined in the relevant CET statute. See infra pages 24-32. The only issue in dispute related to the test for substantiality is whether 25% or more of Genentech's "gross receipts" are derived from the sale of manufactured goods that it manufactures. Simply put, "gross" means "gross" and includes all categories of Genentech's receipts. Genentech should be able to

include its receipts from investments in that computation. When those receipts are included, Genentech clearly does not derive 25% or more of its gross receipts from manufactured goods that it manufactures. The Board erred in not applying the statutory language because it feared an "absurd result." Applying the plain language of the statute would result in Genentech using a three factor apportionment formula. Such a result is not absurd since the United States Supreme Court views a three factor formula as the benchmark against which all other apportionment formulas are judged.

The absurd result of the Board's decision is that if Genentech is deemed to be a "manufacturer" that is required to use a single factor formula to increase its tax, it is also denied the tax credits available to other "manufacturers." Such a tax scheme is unconstitutional as applied to Genentech. See infra pages 33-50. The legislative history surrounding the CET provisions at issue is troubling. There is little doubt that the Legislators contemplated that such a scheme would increase the tax burden for out-of-state manufacturers. Such a scheme is discriminatory and violates the Commerce and Equal Protection Clauses by

increasing the tax burden on out-of-state manufacturing activities while lowering it on in-state manufacturing activities. The scheme also fails the requirements that a tax be fairly apportioned and fairly related to the benefits received.

For all of these reasons, the Board's decision should be reversed and the Notices of Assessment should be canceled.

ARGUMENT

I. Genentech Is Not A Manufacturer Because It Does Not Create New Products By Hand Or Machinery.

The CET statutes define "manufacturing corporation" as a corporation "engaged in manufacturing," which is in turn defined as:

> Transforming raw or finished physical materials by hand or machinery, and through human skill and knowledge, into a new product possessing a new name, nature and adapted to a new use. G.L. c. 63, § 38(1).

This definition of "manufacturing" essentially encapsulates decades of decisions defining manufacturing in the context of other targeted tax incentives for Massachusetts activity. See, e.g., William F. Sullivan & Co. v. Comm'r of Revenue, 413 Mass. 576 (1992) (discussing property tax abatement and income tax credits for manufacturers). In 1996, the Supreme Judicial Court explained that tax credits

for manufacturers were enacted with "[i]dle factories and abandoned mills" in mind. Comm'r of Revenue v. Houghton Mifflin Co., 423 Mass. 42, 46-47 (1996).

Although the concept of a manufacturing incentive was originally intended to preserve mills and factories, the Massachusetts courts have extended the meaning of "manufacturing" to meet economic development objectives. See Joseph T. Rossi Corp. v. State Tax Comm'n, 369 Mass. 178, 181 (1975) (explaining that "the statute should be construed, if reasonably possible, to effectuate [the] legislative intent" of fostering industrial expansion.)

With that intent in mind, it is easy to understand why this Court and the Supreme Judicial Court have interpreted manufacturing so broadly because most of the time, companies are seeking the benefits of that qualification for activities occurring in Massachusetts. See, e.g., Houghton Mifflin, supra; Sullivan & Co., supra; Boston & Me. R.R. v. Billerica, 262 Mass. 439, 444-445 (1928). The Board's holding that the activities conducted by Genentech, an out-of-state company, relating to harvesting and selling organically created proteins constitute manufacturing goes too far.

As the Supreme Judicial Court has noted, this case presents an issue of first impression. See Charles River Breeding Laboratories, Inc. v. State Tax Comm'n, 374 Mass. 333, 335 n.4 (1978) (where the Court "[left] to another day, if it comes, the question whether processes which alter the genetic structure of animals fall within the statutory concept of manufacturing").

Genentech is not engaged in manufacturing because it does not transform a material by hand or machinery nor does it transform a material into a new product. Genentech's activities are akin to mining or breeding, which the Massachusetts courts have repetitively held do not constitute manufacturing.

In Tilcon-Warren Quarries, Inc. v. Comm'r of Revenue, 392 Mass. 670 (1984), the taxpayer excavated rock, loaded it into trucks, hauled it to a plant, and then, using equipment and human skill and knowledge, crushed and screened the rock for size. The finished product was gravel or sand. Id. The gravel and sand were not in the same condition as the source material in the earth. Id. Nevertheless, the Supreme Judicial Court explained that "[e]xtracting pieces of rock from the ground and crushing them into usable sizes does

not compel the conclusion that the process fits within the natural and ordinary meaning of 'manufacturing.'" Id. at 672-673; see also John S. Lane & Son, Inc. v. Comm'r of Revenue, 396 Mass. 137 (1985) (company that converted volcanic rock deposits into finished crushed stone products that are used in the construction industry was not engaged in manufacturing); Se. Sand and Gravel, Inc. v. Comm'r of Revenue, 384 Mass. 794 (1981).

In holding that stone quarrying was "more akin to mining than to manufacturing," the court emphasized that the fundamental character of the rock was unchanged because there was insufficient change in kind and degree to the raw material. Tilcon-Warren at 673. Thus, notwithstanding that the unusable rock in the ground was transformed into usable, and different, gravel and sand, the court nevertheless held this process not to be manufacturing. Id.

Additionally, growing living organisms is not manufacturing, even if the fruits of the growth are harvested and sold. In Charles River, supra, the Supreme Judicial Court held that a large-scale laboratory animal breeder who raised germ and disease-free animals for biomedical research was not a

manufacturing corporation. The taxpayer's business consisted of delivering baby mice and other animals by Cesarean surgery into a sterile environment, then raising and closely monitoring them in a controlled atmosphere. Id. at 334 n.2. Breeding rooms were pneumatically sealed off from the outside world and each room had its own separate air filtration and temperature monitoring alarm systems. Id. at 334 n.3.

The company argued that because its processes required "a heavy investment, skilled personnel, mass production, and reliance on machinery," it was engaged in manufacturing and entitled to tax exemption for its machinery. Id. at 335. The Supreme Judicial Court disagreed, stating that "the breeding of animals is not manufacturing. Manufacturing normally involves a change of some substance, element, or material into something new or different." Id.

The growth and secretion processes at issue here are more akin to the processes in Charles River than to other processes that have been found to be manufacturing. Genentech engages in the large-scale growing of cells - both bacterial and mammalian. Just as Charles River was an animal breeder, Genentech breeds cells. It is the cells that produce the

proteins, not hand or machinery. Hand or machinery is essentially used to plant and harvest.

Genentech's role consists of cultivating the cells as they reproduce and grow. The environment is closely monitored and controlled by Genentech staff. The process requires skilled personnel, mass production, and reliance on machinery, but, like in Charles River, the breeding and growing of these cells should not be considered manufacturing.

One who grows plants and harvests the fruits of those plants is not a manufacturer. Rather, the person is growing the plants and harvesting (extracting) the fruits from the plants. Thus, a company growing corn or tomato plants is not "manufacturing" the corn or tomatoes; it is harvesting the corn or tomatoes made by the plants.

Similarly, the biotech drugs Genentech sells are naturally occurring proteins. The harvesting and packaging of the proteins does not constitute "manufacturing" as defined in the statute. The proteins harvested by Genentech remain, and are sold by Genentech, in their "natural unmanufactured condition" without a change or transformation into something different. Genentech harvests and sells

these proteins for human use without alteration. Genentech simply separates out the proteins produced by the cells, and then packages them into vials, etc. Genentech does not alter the proteins in any way. Any change in name that occurs is for marketing and consumer purposes and not because a new substance is created.

The Board erred in extending the definition of manufacturer to encompass Genentech's activities. The Supreme Judicial Court explained: "We note first of all that taxing statutes are to be construed strictly against the taxing authority, and ambiguities are to be resolved in favor of the taxpayer." Dining Management Services, Inc. v. Comm'r of Rev., 404 Mass. 335, 338 (1989). Absent a clear legislative intent to impose tax on Genentech as a manufacturer, the tax statute must be construed in favor of Genentech.

II. Even If Genentech Is Deemed To Be a Manufacturer, It Is Not "Substantially" Engaged In Manufacturing.

A. Three Factor Apportionment is not an Absurd Result.

The Massachusetts statutes provide that a "manufacturer" must use a single sales factor apportionment formula only if it is engaged in "substantial" part in manufacturing. The Board's

holding that Genentech is substantially engaged in manufacturing is inconsistent with the plain language of the statutory test. Despite the inconsistency, the Board reasoned that the variance was necessary to avoid an "absurd result." A507-508.

Applying the plain language of the statute does not produce an absurd result. It merely results in Genentech apportioning its income using three factor apportionment (property, payroll, and sales) instead of a single sales factor formula. There is nothing absurd about three factor apportionment. In fact, the United States Supreme Court has explained: "[N]ot only has the three-factor formula met our approval, but it has become . . . something of a benchmark against which other apportionment formulas are judged." Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 170 (1983). Moreover, three factor apportionment has its roots in Massachusetts:

> During the twentieth century a broad consensus developed over the country that, for most manufacturing and mercantile businesses, the so-called Massachusetts formula, which averaged the ratios of property, payroll, and sales or gross receipts within the state to the totals throughout the business, ordinarily produced an equitable and workable division of the corporate net income among the states. Hellerstein & Hellerstein, State Taxation, ¶ 8.06(1), 3d ed. (2003) (emphasis added).

The Supreme Judicial Court and other States' courts have acknowledged that the three-factor formula "is widely recognized as a fair method of apportioning net income." See Gillette Co. v. Comm'r of Revenue, 425 Mass. 670, 681 (1997); see also Trinova Corp. v. Dep't of Treasury, 433 Mich. 141, 163 (1989)(three-factor formula is a benchmark); Hess Realty Corp. v. Director, 10 N.J. Tax 63, 86 (Tax. Ct. 1988)(three-factor formula is a benchmark).

B. Genentech is not Engaged in Manufacturing in "Substantial Part" Under the Plain Language of the Statute.

Manufacturing activities will be deemed to be substantial if any one of the tests involving ratios of a taxpayer's property, payroll, and receipts attributable to manufacturing is satisfied. The parties agree that Genentech does not have sufficient payroll or property to be substantially engaged in manufacturing. The only issue in dispute is whether 25% or more of Genentech's gross receipts are derived from the sale of manufactured goods that it manufactures. See G.L. c. 63, § 38(l)(1).

"'[W]here the language of the statute is plain, it must be interpreted in accordance with the usual and natural meaning of the words,' a rule that 'has

particular force in interpreting tax statutes.'" Bridgewater State Univ. Found. v. Bd. of Assessors, 463 Mass. 154, 158 (2012). Moreover, "tax statutes are to be strictly construed according to their plain meaning, as the State has no power to tax unless that power has been expressly conferred by statute." Comm'r of Revenue v. Franchi, 423 Mass. 817, 822 (1996). "There is no power to tax unless such authority is expressly conferred by statute, for it does not arise by implication, and statutes granting the power are to be strictly construed ... the right to tax is 'not to be extended by implication.'" DiStefano v. Comm'r of Revenue, 394 Mass. 315, 325-326 (1985). Moreover, "taxing statutes are to be construed strictly 'against the taxing authority, and all doubts resolved in favor of the taxpayer.'" Franchi, supra at 822.

At issue here is the meaning of "gross receipts" and whether it includes Genentech's receipts from investments. See G.L. c. 63, § 38(1)(1). The statute places no qualifiers on this language - it does not add to or subtract from the term "gross."

Gross receipts are commonly understood to mean the total amount of receipts received, without

deduction for expenses or other items. See, e.g., Dictionary of Banking & Financial Services, J. Wiley & Sons, Inc. (2nd ed. 1985) ("gross receipts" defined as "total receipts prior to deducting expenses"); Black's Law Dictionary (10th ed. 2014) ("gross" defined as "total income from all sources before deductions, exemptions, or other tax reductions") and ("receipt" defined as "something received"); and Merriam-Webster.com, ("gross" defined as "overall total exclusive of deductions") and ("receipt" defined as "something received"), last visited May 28, 2015.

That "gross" means "gross" is confirmed by another part of the same statutory section. Section 38(f) defines the sales factor of the apportionment formula as "gross receipts" less explicitly enumerated items, as follows:

> "[S]ales" means all gross receipts of the corporation, including deemed receipts from transactions treated as sales or exchanges under the Code, except interest, dividends, and gross receipts from the maturity, redemption, sale, exchange or other disposition of securities.

Section 38(f) plainly eliminates the types of receipts at issue here. This qualified use of "receipts" was in the statute before the Legislature's 1995 addition of Section 38(l) regarding manufacturers. G.L. c. 63,

§ 38(f) (1994). Had the Legislature intended to limit the definition of receipts for manufacturing purposes, it clearly knew how to do so. The Legislature was aware of varying treatment of receipts and in Section 38(l), it chose a different approach than in Section 38(f).

The conclusion that "gross receipts" as this term is used in Section 38(1) includes Genentech's receipts from securities sales is further reinforced by well-accepted rules of statutory construction. For example, if an exception to a term or phrase is made in one part of a statute, but not in a second part of the statute where that term or phrase also is used, it is presumed that such exception was not intended in the second part. 2A N.J. Singer, Sutherland Statutes and Statutory Construction, § 47:11. Exceptions (7th ed. 2008)("an exception usually limits only the matter which directly precedes it").

The second applicable canon, known as the rule against surplusage, requires that courts not regard any of the words of statutes as surplusage. See Halpern v. Paolini, 1992 Mass. App. Div. 8, 2 (1992). That is "no portion of a statute should be deemed surplusage, and all sections must be reconciled so as

to achieve a harmonious interpretation of the statute as a whole." See id.; see also Beverages Int'l, Ltd. v. Alcoholic Beverages Control Comm'n, 24 Mass. App. Ct. 708, 712 (1987) ("wherever possible, no provision of a legislative enactment should be treated as superfluous").

In order to achieve a "harmonious" interpretation of Sections 38(1) and 38(f), "gross receipts" as that term is used in Section 38(1) likewise must be interpreted to include gross receipts from the sale of securities. See First Nat'l Bank of Boston v. Bernier, 50 Mass. App. Ct. 756, 759 (2001); Halpern, supra; and Beverages International, supra.

The CET regulations (830 Code Mass. Regs. § 63.38.1(10)(b)(3)) provide that the receipts test is determined in accordance with a property tax regulation (830 Code Mass. Regs. § 58.2.1). Unlike the statute at issue, the property tax regulation contains an express limitation on the meaning of "gross receipts." 830 Code Mass. Regs. § 58.2.1.

The Board erred in looking past the plain statutory meaning of "gross receipts" and applying the Commissioner's property tax regulation to determine the meaning of "gross receipts." A507. The language

of statute G.L. c. 63, § 38(1) does not use the limiting language of the property tax regulation.

Where a state agency has adopted formal regulations that are contrary to the plain language of a statute, the Massachusetts courts have consistently ruled that the regulations are invalid. "[A]n administrative board or officer has no authority to promulgate rules and regulations which are in conflict with the statutes . . ." Bureau of Old Age Assistance of Natick v. Comm'r of Pub. Welfare, 326 Mass. 121, 124 (1950). See also Zayre Leasing Corp. v. State Tax Comm'n, 365 Mass. 351, 356 (1974) (ruling that sales tax regulation was invalid for purposes of taxing prior leases "because it is inconsistent with the statute," which excluded from tax leases entered into before the effective date of emergency sales tax statute). "Gross receipts" is plainly defined in the CET statute and the Board's contrary holding was erroneous.

C. There is no Dispute as to the Material Facts.

At trial, the Commissioner raised several objections to the admissibility and accuracy of the Mellon Spreadsheets. A482. Because the Board found

that no portion of the return of capital was properly included in the analysis of whether Genentech's manufacturing activity was substantial, it did not address the Commissioner's objections. A482.

If this Court finds that Genentech's treasury receipts are included as "gross receipts," then Genentech's "manufacturing" activities do not meet the test to be deemed "substantial" and it is therefore not required to apportion its income based on a single sales factor method. The Board admitted the evidence produced at trial and the Board's reliance on Genentech's witnesses to establish key facts illustrates that the Board found the witnesses to be credible. See 1T120-122; 2T11-13. The question for this Court is a legal issue. If this Court has concerns about the evidence presented quantifying Genentech's treasury receipts then it may remand the case to the Board for findings of fact and a decision on the issue.

III. If Genentech Is Deemed A Manufacturer Substantially Engaged In Manufacturing, Then The Massachusetts Tax Scheme As Applied To Genentech Is Unconstitutional.

The Board's ruling results in an unconstitutional tax scheme as applied to Genentech, an out-of-state

manufacturer. The Board's ruling has the effect of (1) raising the CET liability by treating Genentech as a manufacturer and (2) simultaneously denying the benefits associated with being a "manufacturer" for tax credits. This inconsistent treatment violates the Commerce Clause and Equal Protection Clause of the United States Constitution.

A. The Evolution of Massachusetts' Tax Scheme for Manufacturers.

A historical perspective on Massachusetts' evolving treatment of manufacturers is helpful. Before the 1995 adoption of single sales factor apportionment for manufacturers, the Legislature adopted various incentives for manufacturing occurring in Massachusetts. These included: (1) an investment tax credit (G.L. c. 63, § 31A (enacted 1970)); (2) a research and development credit (G.L. c. 63, § 38M (enacted 1991)); and (3) exemption from local property taxes on machinery (G.L. c. 59, § 5, Sixteenth (enacted before 1950)).

At issue in this appeal are the investment tax credit and the research and development credit (the "Manufacturing Credits"). The statutes offer these manufacturing credits for investment or research and

development occurring in Massachusetts, but not in other states. G.L. c. 63, §§ 31A and 38M.

Prior to 1995, corporations eligible for the Manufacturing Credits and other incentives for manufacturers used three factor apportionment to compute their CET. Thus, their CET liability was based, in part, on the amount of employees, property, and sales in the State. At the time, three-factor apportionment was known nationally as the "Massachusetts formula" and many believed it to be the best formula for taxing manufacturers. See J.X. Donovan, Radical Apportionment Reform Comes to Massachusetts (Dec. 18, 1995) (State Tax Notes, 95 STN 243-12) (three factor apportionment "is commonly referred to as 'the Massachusetts formula,' because the drafters of [a model uniform law] looked to the existing Massachusetts apportionment rules as a model").

Despite the historical record and sound policy reasons behind three factor apportionment, the Legislature adopted single sales factor apportionment for manufacturers in 1995. The rationale behind the bill was that eliminating the property and payroll factor would eliminate a disincentive to buy or rent

additional property or hire additional employees in Massachusetts. See Donovan, Radical Apportionment, supra.

Various options existed for a single sales factor apportionment regime:

Option 1: The first consideration was which companies the change would apply to. Some pushed for single sales factor for all corporations. See T. Moccia, Massachusetts Financial Services Industry May Have Weld's Backing As It Seeks Single Sales Factor (Nov. 21, 1995) (State Tax Notes, 95 STN 224-19). Ultimately, the Legislature made the change only for manufacturers and defense corporations. G.L. c. 63, § 36(k), (l).

Option 2: The second consideration was whether the regime would be elective or mandatory. Under an elective regime, taxpayers could choose to stay with three factor apportionment or move to single sales factor apportionment.

Elective single sales factor does not raise taxes on any taxpayer unless the taxpayer opts for a tax increase. The Department of Revenue recognized this fact, stating during the 1995 legislative process:

> The Raytheon proposal [i.e., elective single sales factor apportionment] would not raise taxes for any [taxpayer] (it allows them to choose between a single sales formula and the current double-weighted sales formula). We assume no company would voluntarily increase its tax burden. Massachusetts Department Of Revenue Estimates Of Raytheon And Related Defense Tax Cut Bills Change The Income Apportionment Factor To Include Sales Only For Defense Contractors (Mar. 22, 1995) (State Tax Notes, 95 STN 160-10) (hereinafter "DOR Report") (copy enclosed in addendum).[5]

If single sales factor apportionment were mandatory, two different results would follow. First, taxes would decrease on taxpayers with greater presence in Massachusetts than in other states. Concerns about a decrease in tax revenue from in-state companies were mitigated by the second result - an increase in taxes on out-of-state corporations. A major appeal of mandatory single sales factor was the increase in taxes on out-of-state companies. The DOR Report states:

> Alternatives that mandated rather than allowed the use of the [single sales factor] would cost the state less, but only because some corporations with most of their payroll and property out of state and proportionally higher sales in-state would see their Massachusetts tax liabilities rise.

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[5] Although some sections of the DOR Report address single sales factor for defense companies, the concepts are equally applicable to manufacturers. Where the report uses the words "defense contractors," this brief uses the word "manufacturers" or "taxpayer."

The DOR Report continues:

> For all corporations, a mandated 100% sales factor in 1991 would have provided the same $169 million tax cut for about 12,000 corporations as an elective 100% sales factor while imposing a $70 million tax increase on about 11,000 corporations.
>
> . . .
>
> [A] mandated 100% sales factor in 1991 would have provided the same $121 million tax cut for about 2,000 corporations as an elective 100% sales factor while imposing a $40 million tax increase on about 2,000 corporations. Id. (emphasis added).

The DOR Report continues by explaining which taxpayers would benefit from "decreased liability":

1. "Corporations with a substantial amount of employment and facilities in Massachusetts that sell nationwide will benefit, especially if sales in Massachusetts represent a small portion of their total sales. This includes large manufacturing corporations and defense contractors." Id. (emphasis added).
2. "In general, domestic corporations will benefit from this proposal." Id. (emphasis added).

The DOR Report then explains which companies would have "increased liability":

> In general, foreign corporations (based in a different state) will pay more from this change in apportionment. Id. (emphasis added).

The DOR Report bluntly refers to companies facing increased liability as "**losers**." Id. (emphasis added).

Other commentators echoed what the Department of Revenue reported about increased taxes on out-of-state companies. Mr. Joseph Donovan, Chair of the Massachusetts Society of Certified Public Accountants' State Taxation Committee, testified to the Legislature:

> I do know, however, that under such a system a major part of the tax savings for Massachusetts-based companies would be borne by other states, and that non-Massachusetts companies whose tax bills would go up would be able to lessen or eliminate this effect by investing in Massachusetts jobs and property. Testimony of Joseph X. Donovan on Behalf of Massachusetts Society of Certified Public Accountants in Support of Adoption of A Single-Factor Apportionment Formula, Joint Committee on Taxation (Oct. 5, 1995) (State Tax Notes, 95 STN 196-26) (emphasis added).

Mr. Donovan wrote elsewhere: "Of course, many non-Massachusetts companies subject to these new rules will find their Massachusetts tax increased . . ." See Donovan, Radical Apportionment, supra.

Not surprisingly, the Legislature decided to impose a mandatory single sales factor for manufacturers, with the intention of decreasing taxes on in-state companies while increasing taxes on out-of-state companies.[6]

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[6] Unlike manufacturers for certain periods, defense corporations could elect single sales factor. See G.L. c. 63, § 38(k).

Option 3: The third decision to make was whether manufacturing would be defined by activities occurring only in Massachusetts or activities occurring anywhere. Ultimately, the Legislature defined "manufacturer" by reference to activities occurring anywhere. G.L. c. 63, § 38(1).

The decision to define "manufacturer" based on activities everywhere was a departure from the many tax incentives described above (e.g., CET credits and property tax), including the Manufacturing Credits. As if raising taxes on out-of-state companies was not enough, this final decision made the tax scheme even more egregious. This was the key to increasing tax on out-of-state companies through single sales factor apportionment and simultaneously denying out-of-state companies the other tax incentives offered to manufacturers.

> The definition of a "manufacturing corporation" that is subject to these rules [i.e., single sales factor apportionment] borrows heavily from the criteria that are used in Massachusetts to determine whether a corporation is a manufacturer for purposes of three other tax benefits -- exemption of machinery from local property taxation, eligibility for the 3 percent investment tax credit, and eligibility for exemption from sales tax for research and development (R&D) equipment and supplies. The principal difference for single-sales-factor purposes is

> that the criteria will be applied to the activities of a corporation everywhere, not just in Massachusetts. This approach was necessary to prevent manufacturers in the aggregate from having the best of both worlds. If "manufacturer" were defined solely on the basis of Massachusetts activities, in-state companies, which tend to benefit from the single-factor approach, would be subject to it, whereas out-of-state manufacturers, for whom it usually represents a tax increase, would not. Donovan, Radical Apportionment, supra (emphasis added).

The foregoing legislative testimony, DOR Report, and other commentary leave little doubt that the Legislature intended to increase tax on out-of-state manufacturers.

B. The Combination of Requiring Single Sales Factor Apportionment and Denying the Manufacturing Credits is Unconstitutional and Results in Differential Treatment.

With that history in mind, the CET tax scheme that imposes a tax increase through single sales factor on Genentech, an out-of-state company, and at the same time denies Genentech the Manufacturing Credits is unconstitutional. The scheme violates three different requirements for the constitutionality of a state tax listed in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 277-279, 287 (1977) for Commerce Clause purposes. These three requirements are: (1) nondiscrimination; (2) fair apportionment (i.e., distortion); and (3) fair relationship to the

benefits provided by the State. Additionally, the tax scheme violates the Equal Protection Clause because it is discriminatory.

The statutory disconnect that arises from the inconsistent treatment of Genentech's manufacturing activities was planned. As explained by a commentator to the legislation:

> The principal difference for single-sales-factor purposes [from other incentives] is that the criteria will be applied to the activities of a corporation everywhere, not just in Massachusetts. This approach was necessary to prevent manufacturers in the aggregate from having the best of both worlds. Donovan, Radical Apportionment, supra.

Indeed, only in-state companies were intended to have the best of both worlds - lower apportionment and the Manufacturing Credits. If anything, the disparate treatment of in-state and out-of-state manufacturers and the blatant intent to raise taxes on out-of-state manufacturers produces an absurd result.

Nondiscrimination: Tax schemes that are "enacted for protectionist purposes" are discriminatory. Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 272 (1984) (stating that a determination that a state tax violates the Commerce Clause "may be made on the basis of either discriminatory purpose . . . or

discriminatory effect"). Id. at 270. In that case, the United States Supreme Court invalidated a tax scheme that benefited in-state manufacturers of alcohol, noting that "we need not guess at the legislature's motivation, for it is undisputed that the purpose of the exemption was to aid Hawaiian industry." Id. at 271.

Importantly, discriminatory credits are one form of an unconstitutional tax. A statute that "discriminates against business carried on outside the State by disallowing a tax credit rather than by imposing a higher tax" is unconstitutional. Westinghouse Elec. Corp. v. Tully, 466 U.S. 388, 404 (1984). That is the case here.

Additionally, tax schemes that have a discriminatory effect are unconstitutional. Best & Co. v. Maxwell, 311 U.S. 454, 455-456 (1940) (stating that the Commerce Clause "forbids discrimination, whether forthright or ingenious" and that "[i]n each case it is our duty to determine whether the statute under attack . . . will in its practical operation [discriminate] against interstate commerce").

> It is, of course, clear that a state tax that discriminates in favor of local over out-of-state interests violates the Commerce Clause

> bar against discriminatory taxes. Indeed, if there is a single theme that characterizes the Court's Commerce Clause cases, it is that out-of-state economic actors are entitled to equal treatment with their in-state competitors. Hellerstein, supra at ¶ 4.14(3)(j).

The CET tax scheme as applied to Genentech is discriminatory because it was intended to and actually did increase CET on Genentech, as an out-of-state manufacturer, while at the same time lowering taxes on in-state manufacturers. It also provides other CET reductions via the Manufacturing Credits to in-state manufacturing activities that it denied to Genentech.

In Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564 (1997), the Court held that the Commerce Clause prohibited a State from denying a property tax exemption to charitable institutions that were operated principally for persons who were not in-state residents. The Court explained that the tax scheme:

> [D]istinguishes between entities that serve a principally interstate clientele and those that primarily serve an intrastate market, singling out camps that serve mostly in-staters for beneficial tax treatment, and penalizing those camps that do a principally interstate business. As a practical matter, the statute encourages affected entities to limit their out-of-state clientele, and penalizes the principally nonresident customers of businesses catering to a primarily interstate market. Id. at 576.

Like in Camps Newfound, the Massachusetts tax scheme at issue here benefits in-state interests - manufacturers that primarily operate in-state. It "penalizes" those manufacturers that operate primarily out of state to "encourage" investment in state. See Donovan, Radical Apportionment, supra ("Of course, many non-Massachusetts companies subject to these new rules will find their Massachusetts tax increased if the distribution of their operations is not changed").

The form of the discrimination does not matter. Thus, the fact that the CET scheme may not facially burden out-of-state companies more than in-state companies or benefit in-state companies more than out-of-state companies does not save the statute. See Bacchus Imports, 468 U.S. at 272.

Moreover, the Commissioner routinely asserts, and the Massachusetts courts have applied, substance over form arguments against taxpayers. IDC Research, Inc. f/k/a Int'l Data Corp. v. Comm'r of Revenue, Dkt. Nos. C267868; C268725; C271245 (Mass. App. Tax Bd. Apr. 17. 2009) ("The substance-over-form doctrine is well established in tax cases"). The same logic applies here - a cleverly conceived tax increase on out-of-state companies combined with multiple tax decreases

on in-state companies cannot stand. It was almost forty years ago that the United States Supreme Court abandoned a "magic words" approach to state taxes and instead focused on practical effects. See Complete Auto, 430 U.S. at 284. The Commerce Clause "forbids discrimination whether forthright or ingenious." Best, 311 U.S. at 455.

The present discrimination also violates the Equal Protection Clause. The clause provides: "[N]or shall any State . . . deny to any person within its jurisdiction the equal protection of the laws." U.S. Const. amend. XIV, § 1. State tax schemes that discriminate violate the Equal Protection Clause.

For example, in Wheeling Steel Corp. v. Glander, 337 U.S. 562 (1949), an Ohio tax scheme imposed tax on the accounts receivable of foreign corporations arising from sales of goods shipped from Ohio manufacturing plants to out-of-state customers and at the same time exempted the accounts receivable of domestic corporations arising from similar sales. The Court held that the tax scheme was "fundamentally discriminatory" against nonresidents, stating: "these discriminations deny appellants equal protection of Ohio law." Id. at 574.

Inasmuch as the Massachusetts tax scheme discriminates against out-of-state manufacturers, it violates the Equal Protection Clause. The unconstitutionality exists either from discriminatory intent or purpose - and both are present here.

The Department of Revenue previously identified Equal Protection as a constitutional concern for single sales factor. It stated: "There might be a constitutional equal protections problem if only defense contractors were permitted to use a single sales factor, while all other corporate taxpayers were required to use the three-factor formula." DOR Report, supra. Although, the DOR Report was presumably contemplating in state companies arguing for single sales factor to be on the same footing as other in-state companies, that principle applies more forcefully here for out-of-state manufacturers. The CET scheme for manufacturers fails equal protection as applied to Genentech vis-à-vis three other groups: (1) in-state manufacturers who received lower tax bills (from single sales factor and the Manufacturing Credits); (2) in-state companies other than manufacturers that continued using three factor apportionment and did not have tax increases; and

(3) out-of-state companies other than manufacturers that continued using three factor apportionment and did not have tax increases. Under any one of the foregoing, the statutory scheme violates Equal Protection.

Fair apportionment: To satisfy the fair apportionment requirement, a tax scheme must be externally consistent - meaning it "must actually reflect a reasonable sense of how income is generated." Container, 463 U.S. at 169. "External consistency . . . looks . . . to the economic justification for the State's claim upon the value taxed, to discover whether the tax reaches beyond the portion of value that is fairly attributable to activity within the taxing State." Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 175-176 (1995). When a tax scheme results in a tax liability that is "out of all appropriate proportion" to the activity conducted in the State, a taxpayer has a right to an alternative apportionment. Hans Rees' Sons v. North Carolina ex rel. Maxwell, 283 U.S. 123, 135-136 (1931). In Hans Rees, the evidence showed that the tax scheme resulted in a tax liability that was 250% larger than under any other reasonable

method. See Container, 463 U.S. at 183-184. In other cases, the Court refused to grant alternative apportionment because there was only a 14% increase in the taxpayer's apportionment factor. Id.

In this case, the evidence demonstrates that there was an approximately 100% differential between Genentech's apportionment factor (i.e., the apportionment factor doubled) under single sales factor as compared to three factor apportionment. EA0874, 0979, 0987, 1014, 1048, 1079, 1103. This doubling of Genentech's CET liability is out of all appropriate proportion to Genentech's activity conducted in the State. Indeed, there was a legitimate dispute below whether Genentech even had enough activity in the State to be subject to CET.

Despite Genentech's minimal presence, the tax scheme sustained by the Board resulted in millions of additional dollars being assessed. EA1164, 1167, 1170, 1173, 1176. Moreover, Genentech could reduce its CET liability via the Manufacturing Credits by doing more in Massachusetts. Thus, the tax scheme actually has an inverse relationship to activity conducted in the State - a blatant failure of external consistency.

Fairly Related To Benefits Provided By The State:

The last Complete Auto prong that is violated in the application of the CET tax scheme to Genentech is the requirement that the tax be fairly related to the benefits provided by the State. Complete Auto, supra 430 U.S. at 277-279. Such benefits include police and fire protection, public roads, and mass transit. There is nothing fair about a regime that reduces taxes for corporations that have a greater in-state presence and increases taxes on corporations that have less of a presence. Such a regime uses out-of-state companies to pay for benefits to in-state companies.[7]

C. The Manufacturing Credits are Unconstitutional Standing Alone.

In Westinghouse, 466 U.S. at 404, the United State Supreme Court identified tax schemes that provide credits for some instead of imposing a higher tax as unconstitutional. That is exactly the case here and for this reason, the Manufacturing Credits, standing alone, are unconstitutional as applied to Genentech.

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[7] For the reasons set forth in the preceding pages, single sales factor as applied to Genentech is unconstitutional. Inasmuch as these issues are subsumed by the unconstitutionality of the entire tax scheme, they are not addressed further.

A federal Court of Appeals struck down an investment tax credit similar to the one at issue here as unconstitutional under the Commerce Clause. Cuno v. DaimlerChrysler, Inc., 386 F.3d 738 (6th Cir. 2004), vacated on standing grounds, 547 U.S. 332 (2006). Unlike that case, which was subsequently vacated on standing grounds, no standing issue exists here because Genentech pays CET and seeks the credits.

CONCLUSION

For the foregoing reasons, the Appellate Tax Board decision should be reversed and the Notices of Assessment should be canceled.

Respectfully Submitted, Dated: June 26, 2015

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CERTIFICATION UNDER RULE 16 OF MASS. R.A.P.

Now comes, Richard C. Call, counsel for the Appellant, and hereby certifies that the Appellant's brief submitted herewith complies with the rules of court that pertain to the filing of briefs, including, but not limited to: Mass. R.A.P. 16(a)(6) (pertinent findings or memorandum of decision); Mass. R.A.P. 16(e) (references to the record); Mass. R.A.P. 16(f) (reproduction of statutes, rules, regulations); Mass. R.A.P. 16(h) (length of brief); Mass. R.A.P. 18 (appendix to the briefs); and Mass. R.A.P. 20 (form of briefs, appendices and other papers).

I further attest that this brief is being filed under Rule 13a and that the day of mailing is within the time fixed for filing by the court.

Richard C. Call (BBO #568836)

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COMMONWEALTH OF MASSACHUSETTS

APPELLATE TAX BOARD

GENENTECH, INC. **v.** **COMMISSIONER OF REVENUE**

Docket Nos.: C282905, C293424, C298502 & C298891

Promulgated: November 17, 2014

These are appeals filed under formal procedure pursuant to G.L. c. 62C, § 39 and G.L. c. 58A, § 7, from the refusal of the Commissioner of Revenue to abate corporate excise for the tax years ended December 31, 1998 through December 31, 2004 ("periods at issue").

Chairman Hammond heard the appellant's motion for summary judgment and the appellee's motion for partial summary judgment, as well as an issue not decided by summary judgment, and was joined in issuing Decisions for the appellee on her motion for partial summary judgment and the remaining issue in these appeals by Commissioners Scharaffa, Rose, Chmielinski, and Good.

These findings of fact and report are made at the request of both the appellee and appellant pursuant to G.L. c. 58A, § 13 and 831 CMR 1.32.

Charles J. Moll III, Esq., *Alan V. Lindquist*, Esq., *Philip S. Olsen, Esq., and Jennifer B. Green, Esq.* for the appellant.

Brett M. Goldberg, Esq. and *Matthew F. Cammarata*, Esq. for the appellee.

FINDINGS OF FACT AND REPORT

Based on an agreed statement of facts and supporting documents as well as exhibits and testimony offered into evidence at the hearing of these appeals, the Appellate Tax Board ("Board") made the following findings of fact.

I. Introduction

Genentech, Inc. ("Genentech" or the "appellant") is a biotechnology company, organized in Delaware in 1976. Headquartered in South San Francisco, California, the appellant is engaged in the research, development, production, and sale of therapeutic drugs used to treat a variety of conditions. Genentech produces these drugs using genetically modified bacteria and animal cells. While Genentech did not maintain an office open to the public in Massachusetts, it did employ a number of employees resident in the Commonwealth, retained title to bulk inventory during a stage of production at a third-party's facility in Massachusetts, and retained title to drugs being used as part of clinical trials conducted by third parties in Massachusetts.

As discussed further in the following Opinion, pursuant to G.L. c. 63, § 38, Massachusetts imposes different apportionment formulas on corporate taxpayers based on the nature of their business activities. Massachusetts requires corporations which are substantially engaged in manufacturing to apportion their income using a single sales factor and all other corporations (apart from those which fall into certain other categories not relevant to these appeals) to apportion their income using a three-factor apportionment formula based on property, payroll, and sales. For tax years ended December 31, 1998 through December 31, 2003, Genentech filed its Massachusetts corporate excise returns using the three-factor apportionment formula applicable to general business corporations. For the tax year ended December 31, 2004, Genentech originally filed its Massachusetts corporate excise return using the single sales factor apportionment formula applicable to manufacturers, but subsequently filed an Application for Abatement claiming that it was not substantially engaged in manufacturing and thus should have been entitled to apportion its income on the standard three-factor basis.

The Commissioner made an assessment of additional corporate excise, arguing that Genentech was substantially

engaged in manufacturing for all periods at issue and thus required to use a single sales factor apportionment formula. Genentech appealed the assessment on four grounds: (1) despite its history of filing returns in the Commonwealth, pursuant to 15 U.S.C. § 381 ("Public Law 86-272"), a federal law that prevents a state from imposing an income tax on a taxpayer whose sole activity in the state is the solicitation of sales of tangible property, its activities were not sufficient to have created nexus; (2) the production of its drugs was not a manufacturing activity; (3) even if the production were considered manufacturing, it did not rise to the necessary level of "substantial manufacturing" when Genentech's gross receipts from redemption and maturity of short-term securities were taken into account; and (4) the restriction of investment tax credits ("ITC") to property placed in service in Massachusetts and research and development credits ("R&D Credits") to costs incurred in Massachusetts is an unconstitutional discrimination against interstate commerce.

II. Jurisdictional Background

These appeals involve two audit cycles of the appellant's corporate excise returns, the first covering the tax years ended December 31, 1998, June 30, 1999, October 26, 1999, December 31, 1999, December 31, 2000, and December 31, 2001 ("1998 - 2001 Audit Cycle") and the second covering the tax years ended December 31, 2002, December 31, 2003, and December 31, 2004 ("2002 - 2004 Audit Cycle").

a. *1998 - 2001 Audit Cycle (Docket No. C282905)*

As a result of the first audit cycle, the Commissioner issued a Notice of Assessment dated July 6, 2005 assessing additional corporate excise in the total amount of $1,125,764, including interest and penalties, for the tax periods ended June 30, 1999, October 26, 1999, December 31, 1999, December 31, 2000, and December 31, 2001.[1] A second Notice of Assessment was issued on July 11, 2005 for the tax year ended December 31, 1998 in the amount of $61,673.95, including interest and penalties. Finally, on September 17, 2005, the Commissioner issued a third Notice of Assessment in the amount of $49,244.08, including

[1] The appellant signed a succession of Forms A-37, Consent Extending the Time for Assessment of Taxes for the tax years ended December 31, 1998 through December 31, 2001, resulting in the extension of the statute of limitations for those tax years ultimately to December 31, 2005.

interest and penalties, of additional corporate excise for the tax year ended December 31, 1999.

Genentech filed an application for abatement, dated September 27, 2005, for all amounts assessed by the Commissioner as a result of the 1998 - 2001 Audit Cycle. The appellant's application for abatement was denied by the Commissioner on January 17, 2006. On March 16, 2006, Genentech timely filed a Petition Under Formal Procedure with the Board.

b. *2002 - 2004 Audit Cycle (Docket Nos. C293424 and C298502)*

Genentech timely filed a Massachusetts corporate excise return for each of the years of the 2002 - 2004 Audit Cycle. The Commissioner issued a Notice of Assessment of additional corporate excise on February 7, 2007 for the 2002 - 2004 Audit Cycle in the amount of $2,027,746, including interest and penalties. The appellant filed an Application for Abatement for the 2002 - 2004 Audit Cycle on March 9, 2007, which was denied by the Commissioner on June 11, 2007 with respect to the 2002 and 2003 tax years, but she neither expressly allowed nor denied the appellant's claim with respect to the 2004 tax year. On August 10, 2007, Genentech timely filed a Petition Under Formal Procedure with the Board appealing the

Commissioner's refusal to abate additional corporate excise assessed for the 2002 - 2004 Audit Cycle (Docket No. C293424).

On March 1, 2008, Genentech filed a second Application for Abatement for the year ended December 31, 2004, which was denied on June 6, 2008. On August 1, 2008, Genentech timely filed a Petition Under Formal Procedure appealing the Commissioner's refusal to abate additional corporate excise assessed for the 2004 tax year (Docket No. C298502). Also on March 1, 2008, Genentech filed a second Application for Abatement raising issues which had not been raised in previous applications, namely that if the Commissioner required the appellant to file as a manufacturing corporation, it should be entitled to Massachusetts ITC on purchases of qualified manufacturing property placed in service outside of the Commonwealth. By letter dated October 24, 2008, Genentech withdrew its consent for the Commissioner to act on this second Application for abatement and thereafter filed a second Petition Under Formal Procedure with the Board on December 22, 2008 (Docket No. C298891).

Based on the foregoing, the Board found that it had jurisdiction to decide these appeals for both audit cycles. Genentech filed a Motion for Summary Judgment with the

Board, which the Board denied. The Commissioner filed her own Motion for Partial Summary Judgment on the issues of whether Genentech had nexus with the Commonwealth and was engaged in manufacturing activity. A hearing was then held on the issue of whether Genentech was engaged in substantial manufacturing activity. For the reasons set out below, the Board found that for all of the years at issue, the factual record was sufficient to find and rule on summary judgment that Genentech had nexus in Massachusetts and was engaged in manufacturing activities. The Board also ruled that the Massachusetts ITC and R&D credit statutes do not infringe upon the appellant's rights under the U.S. Constitution. Upon further hearing on the remaining issue, the Board found that Genentech was substantially engaged in manufacturing activities and was therefore required to use a single sales factor apportionment formula to apportion its income to Massachusetts.

III. Nexus of Appellant With Massachusetts

a. *Alkermes Co-Development and Manufacturing Relationship*

On January 9, 1995, Genentech entered into a Collaborative Development Agreement with Alkermes Controlled Therapeutics, Inc. ("Alkermes"), a third-party pharmaceutical manufacturer headquartered in Massachusetts

("Alkermes Collaborative Development Agreement"). Alkermes possessed encapsulation technology which it used to create slow-release formulations of drugs, allowing them to be administered less frequently. Genentech and Alkermes agreed to investigate whether Alkermes' encapsulation technology could be incorporated into Genentech's human growth hormone ("hGH") drug, marketed under the name Nutropin®, to create a slow-release formulation for commercial sale. Pursuant to the terms of the Alkermes Collaborative Development Agreement, Genentech agreed to provide bulk[2] hGH to Alkermes at no cost to be used in the development process and in clinical studies.

On November 13, 1996, as the two parties continued the development process, Genentech entered into a formal license agreement with Alkermes, whereby Alkermes licensed their encapsulation technology to Genentech to be used in creating sustained release formulations of hGH in return for a royalty based on net sales of any resulting drug approved for commercial sale as well as certain milestone payments ("Alkermes License Agreement").[3] As a result of the collaboration between the parties, in late December 1999,

[2] "Bulk" product refers to a drug or pharmaceutical that has been produced into a raw or "bulk" state that is ready for further processing and to be packaged into its final dosage form.

[3] A subsequent version of the License Agreement between Alkermes and Genentech was entered into on April 14, 1999. However, there was no material change to the terms outlined above.

Genentech received approval from the Food and Drug Administration ("FDA") for a slow-release version of hGH. Genentech consequently entered into a Manufacturing and Supply Agreement effective January 1, 2000 with Alkermes ("Alkermes Manufacture and Supply Agreement")[4] to begin manufacture of the drug for commercial sale under the name Nutropin Depot, which began in 2000. Genentech would ship bulk hGH in a frozen state in large 400L to 1,000L tanks to Alkermes's manufacturing facility in Massachusetts, where a designated manufacturing suite was kept for the production of Nutropin Depot. Under the terms of the Alkermes Manufacture and Supply Agreement, Genentech agreed to provide bulk hGH to Alkermes at least fourteen days before any predetermined processing date. During the course of the manufacturing relationship, shipments occurred generally one to two times per month.

After encapsulation and quality testing, Alkermes would fill the resulting product into vialed, unlabeled dosage containers and package them with any requisite diluent and administration needles. Once in this finished form, the drug would be shipped back to Genentech in California to be labeled and sold. While Alkermes stored

[4] An Amended Manufacturing and Supply Agreement was executed by the parties on February 20, 2002, but the amendments did not affect any of the provisions described below.

and handled the bulk, Genentech, by the terms of the Alkermes Manufacturing and Supply Agreement, retained title to all bulk drug inventory work in progress at all times while in Alkermes' Massachusetts facility. Due to the limited commercial success of Nutropin Depot as compared to other forms of Nutropin®, the parties agreed to formally cease production in April 2005.

The record contained discrepancies about the amount of inventory work in progress that Genentech held title to at Alkermes' facility during the years at issue. Genentech's property apportionment schedules showed that the appellant owned $529,000 worth of inventory in the Commonwealth at the end of 1999 (despite the fact that commercial sale did not begin until 2000), $2,496,451 worth of inventory in 2000, $1,986,012 worth of inventory in 2001, $3,173,776 worth of inventory in 2002, and $4,571,219 worth of inventory in 2003. For 2004, the apportionment schedule reflected zero inventory. However, this does not comport to what was reported on Genentech's Massachusetts tax returns for the 2004 tax year, which showed $2,306,986 of property owned by Genentech in Massachusetts for apportionment purposes for the 2004 tax year. Given the level of inventory in prior years at the Alkermes facility and that the manufacturing relationship extended through

2005, the Board found that the Massachusetts property shown on the appellant's 2004 tax return represented inventory kept at Alkermes' Massachusetts facility.

Under the terms of the Alkermes Manufacturing and Supply Agreement, Genentech had the option to install capital equipment at Alkermes' manufacturing location, to which it would retain title, and to maintain a reasonable number of its own employees on-site at the Alkermes facility to oversee the manufacturing process. The appellant was not able to establish definitively whether any such capital equipment was installed or whether there were any employees present at the Alkermes facility. However, as the Board found that the inventory property in Massachusetts owned by Genentech was sufficient in and of itself to create nexus for all the years of the appellant's collaboration with Alkermes, the Board did not need to reach the question of whether there were any additional assets or whether Genentech employees were present on-site.

b. *Property in Massachusetts in the 1998 Tax Year*

Genentech's property apportionment workpapers included in the record showed that it owned $86,774 of machinery and equipment located in Massachusetts during the 1998 tax

year.[5] Per its Federal Form 1120 for the 1998 tax year, Genentech's total assets at the end of 1998 were $2,906,451,261, including inventory of $148,625,645 and buildings and depreciable assets with an original cost of $1,075,949,590. Genentech asserted that this property consisted of "computers, printers, and other property provided to Genentech's salespeople for use in their sales solicitation activities." GENENTECH'S MOTION FOR SUMMARY JUDGMENT AND SUPPORTING MEMORANDUM OF POINTS AND AUTHORITIES at 24. The workpapers show that the total may be broken down into categories as follows:

Table 1

Summary of 1998 Massachusetts Property

Property	Original Cost	Accumulated Depreciation	Net Book Value
Compaq Proliant 5000	$44,982	$19,680	$25,302
Storage Dimensions Tape Drive and Optical Fibers	6,543	1,330	5,213
Castelle FaxPress and Uninterrupted Power Source	10,380	2,162	8,218
IBM and Dell Computers/Laptops and Printer	9,421	9,421	0
Medical Testing Equipment and Software (e.g., HPLC Detectors, Biflow Sensors, Capillary Tubes)	14,650	12,113	2,537
Miscellaneous	798	25	773
Grand Total	**$86,774**	**$44,731**	**$42,043**

[5] This figure varies immaterially from the amount of property reported on Genentech's Schedule F of its Form 355 of $86,969.

Apart from the cursory explanation that the property was a *de minimis* amount of ancillary property provided to sales people, Genentech did not offer any evidence as to what the property was used for.

As shown above, $9,421 of the total Massachusetts property was made up of computers and printers. However, more than half of the property appears to have consisted of $44,982 of computer equipment and a computer tape storage drive and fiber optic cables worth $6,543. The remaining property included $14,650 of medical equipment, including HPLC Detectors, diagnostic spirometers, biflow sensors, and capillary tubes, as well as laboratory testing software. The appellant contends that this latter property "was fully depreciated and presumably no longer in use or had been disposed of but not yet removed from Genentech's books." GENENTECH'S REPLY TO THE COMMISSIONER'S OPPOSITION TO GENENTECH'S MOTION FOR SUMMARY JUDGMENT at 41. However, no evidence was offered to support this supposition that the property was no longer in use in the Commonwealth or how the equipment was being used by Genentech employees in a manner that was ancillary to the solicitation of sales. Based on the foregoing, the Board found that the appellant owned or used machinery and equipment in the Commonwealth in 1998 and did not meet its

burden of proof to show that the property was *de minimis* or entirely ancillary to the solicitation of sales.

c. *Massachusetts Clinical Trial Activities*

During each of the tax years at issue, Genentech engaged with various contract research organizations ("CROs") in Massachusetts, which were third parties hired to conduct a clinical trial with human subjects to test the efficacy of the appellant's drugs. The CROs were responsible for the selection of the site of the study, the patient subjects to be included, and selection of the principal investigator. According to the appellant, while Genentech scientists or physicians may have been involved in writing the protocols of a trial, no Genentech personnel ever conducted any clinical trial or monitored or evaluated any trials in Massachusetts. However, Genentech was required to retain title to any material being tested during clinical trials. Any materials not used by the investigator were required to be returned to Genentech or destroyed.

Genentech did not maintain records of the amounts of drugs used in the clinical trials; however, based on contracts in the record, Genentech had engaged Massachusetts based CROs to conduct clinical trials over a number of years to study the following numbers of

anticipated subjects, beginning in each of the following years: 25 subjects in 1998; 30 subjects in 1999; 27 subjects in 2000; 30 subjects in 2001; 1,998 subjects in 2003; and 205 subjects in 2004. Genentech itself noted that because of the complexity involved in development and production, the "astronomical" cost of its drugs can run to hundreds of thousands of dollars per patient once approved by the FDA. GENENTECH'S REPLY TO THE COMMISSIONER'S OPPOSITION TO GENENTECH'S MOTION FOR SUMMARY JUDGMENT AT 31. Therefore, the Board found that Genentech's continued ownership of the drugs being tested represented the ownership or use of property in the Commonwealth and that the amount and value of property was not *de minimis*.

d. *Activities Engaged in by Genentech Employees in Massachusetts*

Genentech employed between nine and twenty-eight people in Massachusetts during the years at issue. Most of the Massachusetts employees were "clinical specialists" or "senior clinical specialists," sales representatives that met with physicians and other health care providers to promote the use of Genentech drugs with the goal that through these efforts, doctors would be more likely to prescribe Genentech drugs to their patients. While these meetings would most often occur in a clinical setting,

clinical specialists often met with healthcare providers over lunch or at other informal venues, such as sporting events. New clinical specialists were trained in California and all clinical specialists based in the northeast region of the United States met at twice yearly sales meetings in either New York or Boston.[6]

Clinical specialists conducted hands-on demonstrations to teach nurses the correct method for injection. The clinical specialists were first trained on the proper mixing of the product for injection and their trainers also filmed an instructional video displaying the process, which the clinical specialist would leave with the nurses being trained as a reference. Genentech employed two sales managers who oversaw the activities of clinical specialists in Massachusetts, one of whom, Kelli Wilson, lived in the Commonwealth, and the other of whom, John Mastrianni, lived

[6] Stephen Fauci, a former Genentech senior clinical specialist based in Massachusetts, alleged that there was a widespread practice among clinical specialists to complete Statements of Medical Necessity ("SMNs"). SMNs are statements issued by a doctor to a patient's insurance provider. Mr. Fauci was terminated by Genentech in 2005 and has subsequently filed a wrongful termination suit in federal court, alleging that his firing was due to his repeated reporting to supervisors of alleged illegitimate sales tactics. Genentech contested Mr. Fauci's allegations and maintained that the completion of SMNs by clinical specialists would be improper, against corporate policy, and did not occur to Genentech's management's knowledge. The Board did not make a determination as to whether Genentech clinical specialists engaged in this behavior in Massachusetts during the periods at issue as it found and ruled that other activities were sufficient to create nexus.

outside of the Commonwealth but periodically travelled to Massachusetts as part of his job duties.[7]

In addition to clinical specialists, Genentech employed Medical Science Liaisons ("MSLs"), individuals with medical and scientific backgrounds that were not part of the Genentech sales organization. MSLs, who because of their background could speak to issues such as off-label use or drug interaction in a way that clinical specialists were not able to, served as technical field resources for clinical healthcare providers. MSLs were also integral in coordinating presentations given by "thought leaders," doctors and researchers who were eminent in a certain field of medicine. These thought leaders, who generally were contracted by Genentech through a speaker's bureau in return for an honorarium, gave presentations organized by Genentech to medical professionals.

[7] Genentech leased office space for Kelli Wilson to use instead of a home office during 2003 and 2004 because she could not receive internet access at her home. Because the Board found and ruled that nexus was present for those years due to the Alkermes inventory, it did not need to reach a conclusion as to whether this office created nexus in Massachusetts.

John Mastrianni was a sales manager for the periods at issue until 2004 when he transitioned into a new role as part of Genentech's managed care division. The managed care division sought to increase awareness among health insurance companies of Genentech's products, by providing clinical information about new drugs and indications with the aim that the insurance companies would cover the cost when prescribed to a patient who was a policy holder. As the cost of Genentech's drugs was very high for an average person, many patients would not be able to take them without insurance coverage. Mr. Mastrianni visited the Commonwealth two to three times a year to conduct his duties. Mr. Mastrianni replaced another Genentech employee who lived outside of Massachusetts that performed the same responsibilities described above in the Commonwealth until that person retired in 2004.

For the reasons set out in the following Opinion, the Board ruled that solicitation of doctors to increase prescriptions to patients of Genentech drugs was not a nexus creating activity pursuant to Public Law 86-272. While certain activities of the MSLs and managed care division employees may have exceeded the scope of Public Law 86-272, the Board did not reach the issue as it found and ruled that Genentech's ownership of tangible property

was already sufficient to establish nexus in Massachusetts.[8]

IV. Manufacturing Activities of Appellant

Unlike traditional pharmaceutical companies that generally combine chemical compounds to produce drugs, Genentech is a "biotechnology" company which develops drugs produced by living cells. Genentech genetically modifies these cells to produce a protein with a desired pharmacologic effect, called a "protein of interest." There are four stages of Genentech's drug production process: (1) alteration the deoxyribonucleic acid ("DNA") or genetic code of a living cell to instruct it to produce the protein of interest; (2) production of the desired protein by genetically altered cells; (3) purification of the desired protein; and (4) formulation and packaging of the resulting bulk drug for sale to the public. All of Genentech's drug production activities took place outside of Massachusetts, other than activities undertaken as part of the collaboration with Alkermes.

[8] Per the employee roster provided (which only covered the 2004 tax year), Genentech also employed individuals with the following job descriptions that would appear on their face to fall outside of the sales organization: (1) Senior Professional Education Liaison; (2) Professional Education Liaison; (3) Vice President, Manufacturing Collaboration and Contract Manufacturing; (4) Senior Manager, Quality; and (5) Product Manager. The appellant did not provide any evidence regarding the duties of these individuals or when these individuals began working for Genentech in Massachusetts.

While the proteins that form the basis for Genentech's drugs occur naturally, Genentech developed the technology to synthetically mass produce them. This is done by introducing a DNA sequence into a cell's genetic code which then "transforms" the cell, directing it to produce the protein of interest. The insertion of the gene is facilitated by the use of polyethylene glycol, which alters cell membrane permeability. Simple biotechnology drug compounds such as insulin and hGH are produced using E. coli, while more complex drugs such as Avastin®, a Genentech treatment for cancer, are produced using Chinese hamster ovary cells. Genentech then allows the cell line to grow and reproduce, with each cell copy carrying the genetic modification that instructs it to produce the protein. Genentech acclimatizes the cells in larger and larger tanks, ranging in size up to 25,000L for 3 days to 2 weeks, to continue their growth. Genentech employees feed the cells glucose and other nutrients and closely monitor their environment.

Once the proteins have been expressed, they must be purified by separating and isolating them from the mix of cells and other material present. Genentech must also extract any proteins that are not directly expressed into the solution by "disrupting" or breaking down the cell

walls containing them. The filtration processes used by Genentech typically include ultrafiltration, where the solution is passed through the microscopic pores of a membrane acting as a sieve to separate material by size, and chromatography, where solution is passed through a column to fully separate the protein from any other unwanted solution components. There are three common types of chromatography processes: affinity, size exclusion, and ion exchange chromatography. In affinity chromatography, antibodies are introduced into the column that will bind to the desired protein to help extract it. Size exclusion filters based on the size of the desired protein while ion exchange chromatography uses the difference in electrical charges of the protein and other components to separate the two. After the purification process, the bulk drug is delivered to other facilities where it is formulated as required and filled into its final dosage form, which is labeled and packaged for individual patient use. The packaged drug is delivered to distributors or directly to physicians, hospitals, and pharmacies around the world.

As further explained in the following Opinion, the Board found and ruled that the appellant's production of drugs through the introduction of semi-synthetic genes used to alter the genetic code of living organisms to produce

proteins which must be extracted and purified, involves sufficient man-made physical change to be treated as manufacturing for Massachusetts corporate excise purposes under G.L. c. 63, § 38(*l*).

V. Substantial Manufacturing Activities of Appellant

In order to be treated as a manufacturing corporation for tax purposes, a taxpayer's manufacturing activity must be "substantial," which has been defined by statute as meeting certain thresholds comparing the level of the taxpayer's property, payroll, and sales related to its manufacturing activities to its total property, payroll, and sales from all activities. The parties agreed that Genentech's property and payroll proportions fell short of the thresholds in the years at issue. However, Genentech would nonetheless be designated a manufacturing corporation if it had derived a sufficient percentage of its gross receipts from the sale of goods which it manufactured, which the Board found and ruled included sales of its drugs. Where the parties disagree is whether gross receipts for this purpose should not only include revenue such as product sales, interest, dividends, royalties, capital gain, and other business income included in taxable income, but should also include gross proceeds from the maturity and redemption of short-term securities.

Genentech's treasury department managed the investment of the appellant's excess cash in short-term securities. Genentech maintained eleven accounts to hold these short-term assets at Mellon Bank ("Mellon Accounts"), which held money market funds, commercial paper, and treasury bonds. Money market funds are pooled investment vehicles that differ from other types of investment funds in that they aim to maintain a consistent net asset value ("NAV") of $1 per share. See Mark Perlow, ***Money Market Funds - Preserving Systemic Benefits, Minimizing Systemic Risks***, 8 Berkeley Bus. L.J. 74, 76-77 (Spring 2011). Unlike shares of other equity investments, the price of which is expected to fluctuate, investors generally expect to be able to redeem their shares of money market funds for the amount originally invested, while earning interest or dividends throughout the term that they hold shares in the fund.

Id. at 77. During the periods at issue, the money market funds held in the Mellon Accounts maintained a $1 NAV, thus allowing Genentech to redeem for the purchase price with no gain or loss.[9]

Commercial paper is a short-term debt instrument that is usually issued by a corporation in order to meet working capital needs as an alternative to a bank loan. *Id.* Van Bui, the appellant's treasurer, testified that Genentech's treasury department, which ranged from two to seven employees in California, would assess Genentech's cash needs on a daily basis and would accordingly liquidate investments to free up cash or invest excess cash into short-term securities, as necessary. The receipts recorded in the Mellon Accounts included dividends, interest, and return of capital through the redemption or maturity of securities. There were no capital gains or losses generated in the Mellon Accounts during the years at issue, despite the enormous amount of securities that were purchased and sold, meaning Genentech was able to either redeem the

[9] The appellant highlighted that a money market fund is not an investment without risk as the value of its shares may fall. While there is a risk that the NAV of a money market fund will fall below $1 per share, known as "breaking the buck," this has only actually happened three times, with the most recent occurrence in September 2008, at the nadir of the financial crisis, when the NAV of a money market fund called Reserve Primary Fund fell temporarily to 97 cents. Diya Gullapalli, Shefali Anand, and Daisy Maxey, ***Money Fund, Hurt by Debt Tied to Lehman, Breaks the Buck***, Wall Street Journal, Sept. 17, 2008, at C3.

securities in every instance for the same amount as it paid for them or hold them to maturity.

The redemption and maturity of the short-term securities resulted in gross proceeds. Assume an example where Genentech used $100 of excess cash to purchase 100 shares of a money market fund. Over the course of 30 days, Genentech earned $2 in interest, but when a need arose for $100 to be used in the business, Genentech redeemed its 100 shares for $100 in cash. The disagreement between the parties boils down to whether, for purposes of determining the percentage of its receipts that were derived from manufacturing, Genentech should be able to claim gross receipts of $102, comprised of the $2 in interest plus the $100 return of capital which the appellant had originally invested and then redeemed, or just the $2 in profit. Due to the volume of transactions whereby Genentech redeemed and reinvested cash on an almost daily basis, the two methods yield vastly different results:

Table 2 - Manufacturing Receipts - No Return of Capital Included				
Year	Gross Receipts from the Sale of Manufactured Drugs	Other Income (royalties, etc.)	Total Business Receipts	% of Sales from Manufacturing
1998	732,072,208	421,188,311	1,153,260,519	63.5%
1999	1,044,396,528	352,429,204	1,396,825,732	74.8%
2000	1,277,114,954	608,971,609	1,886,086,563	67.7%
2001	1,757,383,569	701,455,417	2,458,838,986	71.5%
2002	2,167,681,513	468,187,220	2,635,868,733	82.2%
2003	2,629,672,632	987,002,520	3,616,675,152	72.7%
2004	3,642,361,423	935,735,394	4,578,096,817	79.6%

Table 3 - Manufacturing Receipts - Return of Capital Included					
Year	Gross Receipts from the Sale of Manufactured Drugs	Total Business Receipts	Total Return of Capital	Total receipts with Return of Capital	% of Sales from Manufacturing
1998	732,072,208	1,153,260,519	17,836,392,054	18,989,652,573	3.9%
1999	1,044,396,528	1,396,825,732	22,582,749,670	23,979,575,402	4.4%
2000	1,277,114,954	1,886,086,563	13,530,052,242	15,416,138,805	8.3%
2001	1,757,383,569	2,458,838,986	28,706,747,792	31,165,586,778	5.6%
2002	2,167,681,513	2,635,868,733	28,065,938,152	30,701,806,885	7.1%
2003	2,629,672,632	3,616,675,152	22,251,732,041	25,868,407,193	10.2%
2004	3,642,361,423	4,578,096,817	34,648,742,481	39,226,839,298	9.3%

The proceeds from the redemption and maturity were not included in the computation of Genentech's revenue on its publicly available financial statements, were not included in the computation of gross receipts reported on Genentech's Form 1120 federal corporate income tax return used to determine taxable income, and were not included in the total receipts used to compute sales factor

apportionment in California (which, unlike Massachusetts, includes certain receipts from the sale of securities). For the reasons detailed in the following Opinion, the Board found and ruled that to include the return of capital in the computation of the proportion of Genentech's receipts that was derived from manufacturing generated a distorted and absurd result that did not reflect the true nature of its business activities. Accordingly, the Board found and ruled that Genentech's manufacturing activity was substantial for the periods at issue and it was therefore required to apportion its income using a single sales factor.

Mellon Bank acted as custodian over the Mellon Accounts and kept the records of all deposits, withdrawals, sales and purchases of securities, redemptions, and receipt of interest and dividends. Genentech did not keep its own records of transactions within the Mellon Accounts and relied on Mellon's employees to do so. In order to produce evidence of the amount of return of capital proceeds, Genentech requested that Mellon employees produce historical reports for purposes of the hearing of these appeals ("Mellon Spreadsheets"). Genentech was unable to locate the compact discs which had been contemporaneously provided to them during the periods at issue containing

their trade records. No employee of Mellon testified at the hearing about how the records were produced. The Commissioner raised several objections to the admissibility and accuracy of the Mellon Spreadsheets. As the Board found that no portion of the return of capital was properly included in the analysis of whether Genentech's manufacturing activity was substantial, it did not reach these objections.

VI. Constitutionality of Denial of Massachusetts Investment Tax Credits and Research and Development Credits to Appellant

Massachusetts provides manufacturers with the ability to claim ITC of a percentage of their expenditures on qualified property placed in service in Massachusetts and corporations engaged in research and development with the ability to claim an R&D Credit of a percentage of their expenditures on research activity conducted in Massachusetts. All of Genentech's activities which would otherwise have qualified for credits took place outside of Massachusetts. California provides similar credits for investments and research and development by a manufacturer in California, which Genentech qualified for and took on its California corporate income tax return for each of the years at issue.

Genentech argued that it was entitled to Massachusetts credits on its expenditures because Massachusetts only offered the credits to taxpayers conducting in-state activity in violation of the Commerce Clause of the U.S. Constitution. As explained in the following Opinion, the Board ruled that the Massachusetts ITC and R&D Credit statutes are constitutional as applied to Genentech, and that Genentech was not entitled to claim any credits for the periods at issue.

VII. Summary of Findings

As discussed in the following Opinion, the Board found and ruled that: (1) the appellant's ownership of property in Massachusetts was sufficient to create nexus for all periods at issue; (2) the appellant was properly treated as a corporation which was engaged in manufacturing activity; (3) the revenue generated from that activity was substantial when measured against its gross receipts, not including the return of capital; and (4) the appellant was not entitled to claim any Massachusetts tax credits related to its activities outside of the state. Accordingly, the Board issued a decision for the appellee in these appeals.

OPINION

Pursuant to 831 CMR 1.22, "issues sufficient in themselves to determine the decision of the Board or to narrow the scope of the hearing may be separately heard and disposed of in the discretion of the Board." Thus, the Board may hear and decide cases where there is no genuine issue of material fact and a party is entitled to judgment as a matter of law. ***Sears, Roebuck & Co. v. Commissioner of Revenue***, Mass. ATB Findings of Fact and Report 2012-1, 5; ***Rossi v. Commissioner of Revenue*** Mass. ATB Findings of Fact and Reports 2003-473, 475-76. Genentech and the Commissioner both filed Motions for Summary Judgment arguing that there were no genuine questions of material fact and that each was entitled to judgment in its favor as to whether the appellant had nexus in Massachusetts for the tax periods at issue and whether it was engaged in manufacturing activity. The Board found that the factual record supporting the parties' motions was sufficient to reach a ruling on the issues of nexus, whether the appellant was engaged in manufacturing activity, and whether the denial of Massachusetts tax credits was unconstitutional, as applied to the appellant. Therefore, the Board found it appropriate to decide these three issues on summary judgment.

I. Genentech's Activities in Massachusetts Were Sufficient to Create Nexus

Massachusetts levies a corporate excise on any corporation which exercises its charter, does business, or owns or uses any part of its capital, plant or other property in the Commonwealth. G.L. c. 63, § 39. The Commissioner, pursuant to the authority granted by the Legislature in G.L. c. 62C, § 3, promulgated a regulation, 830 CMR 63.39.1, describing the circumstances under which a foreign corporation will be subject to tax as required by G.L. c. 63, § 39. *See* ***Geoffrey, Inc. v. Commissioner of Revenue***, 453 Mass. 17, 22 (2009). Pursuant to 830 CMR 63.39.1(4)(d)(1), a corporation is deemed to own or use property in Massachusetts if it "owns property that is held by another in Massachusetts under a lease, consignment, or other arrangement..."

Beginning in 1999 through the end of the periods at issue, Genentech held title to bulk Nutropin in Massachusetts while it was transformed by the integration of Alkermes' slow-release technology and packaged into doses ready for labeling. During the periods at issue, the value of inventory to which Genentech held title in Massachusetts averaged in the millions of dollars. The Alkermes Manufacture and Supply Agreement was an ongoing

collaboration between the parties whereby Genentech regularly shipped out large quantities of bulk Nutropin to Massachusetts, on the order of once or twice a month, resulting in a constant store of inventory in progress. In ***Universal Instruments Corp. v. Commissioner of Revenue***, Mass. ATB Findings and Reports 1998-407, 410-411, the taxpayer had placed inventory on consignment at customer locations in the Commonwealth either to allow a customer to test equipment before purchase or as an interim solution while the taxpayer was designing a specific piece of equipment for a particular customer. The Board found that the consignment of inventory, which amounted to $65,727 in 1983 and $86,360 in 1984, constituted the ownership or use of property in Massachusetts sufficient to create nexus. ***Id.*** This was the case even though the customer had possession and control of the inventory while placed at their location. ***Id.***

The only statutory exemptions to the imposition of tax in the case of a corporation which owns property located in the Commonwealth are if (1) the tax would be precluded by the U.S. Constitution; (2) the tax would be precluded by Public Law 86-272; or (3) the property is stored in a licensed public storage warehouse that is not owned or leased by a consignor or consignee of the property being

stored. G.L. c. 63, § 39. Public Law 86-272 is a federal statute that prevents a state from imposing tax on a taxpayer whose only activities in the state are the "solicitation of orders... in [the] State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State." 15 U.S.C. § 381(a).

Genentech has not argued that the property placed at Alkermes' facility was related to the solicitation of sales or was housed in a public warehouse. The Supreme Judicial Court ("SJC") has found the physical presence of property owned by the taxpayer in the state to be a constitutional basis for imposing corporate excise, even if it is used there only by a third party. *See* ***Truck Renting and Leasing Assoc., Inc. v. Commissioner of Revenue***, 433 Mass. 733, 741 (2001); ***Aloha Freightways, Inc. v. Commissioner of Revenue***, 428 Mass. 418, 423 (1998). The taxpayer in ***Truck Renting and Leasing Associates, Inc.*** did not have any presence in Massachusetts apart from the fact that it knowingly leased vehicles to which it retained title and which the taxpayer knew would be partially used by the lessees in Massachusetts to transport goods. 433 Mass. at 734-735. The Court found that the significant use of the taxpayer's

property in Massachusetts by its lessees was sufficient to satisfy due process and establish a substantial nexus with the Commonwealth for purposes of the Due Process and Commerce Clauses. ***Id.*** at 741.

Genentech argues that the holding in ***Truck Renting and Leasing Assoc., Inc.*** does not apply because unlike the taxpayer in that case, the appellant does not derive income from the use of property in Massachusetts. However, that was only one factor considered by the SJC as to whether the taxpayer had the requisite minimum contacts to satisfy the Due Process clause. ***Id.*** at 737. The Court noted that the requirement was also satisfied if a taxpayer "purposefully avails" itself of the "privilege of conducting activities" in the Commonwealth. ***Id.*** at 738 (quoting ***Quill Corp. v. North Dakota***, 504 U.S. 298, 307 (1992) and ***Hanson v. Denckla***, 357 U.S. 235, 253 (1958)). Thus the taxpayer, which "allowe[d] and facilitate[d] its lessees to use its property within the taxing state," had sufficient minimum contacts therewith. ***Id.*** Genentech met that standard as it allowed and facilitated Alkermes' use of the bulk hGH in Massachusetts. Therefore, the Board ruled that the inventory property to which Genentech held title in Massachusetts was sufficient in and of itself to create nexus for the 1999 through 2004 tax years.

Genentech did not have a material amount of inventory at Alkermes' Massachusetts location until 1999. For the 1998 tax year, however, Genentech owned $86,774 of tangible property in Massachusetts, with a net book value of $42,043. The appellant bears the burden of establishing its right to an abatement by the preponderance of the evidence, including proof that the taxpayer was not subject to the corporate excise tax when it claims its activities are protected under Public Law 86-272. ***Advanced Logic Research, Inc. v. Commissioner of Revenue***, Mass. ATB Findings of Fact and Reports 2008-19, 28. Genentech stated in its Motion for Summary Judgment that the property consisted "of computers, printers and other property provided to Genentech's salespeople for use in their sales solicitation activities" and thus within the scope of Public Law 86-272. GENENTECH's MOTION FOR SUMMARY JUDGMENT AND SUPPORTING MEMORANDUM OF POINTS AND AUTHORITIES at 24. However, the appellant did not provide any further detail or explanation as to what the assets constituted and how they were used in Massachusetts.

Genentech cites to ***Wisconsin Dept. of Revenue v. Wrigley*** (***"Wrigley"***), 505 U.S. 214 (1992), the leading Supreme Court case drawing the boundaries of permissible activities under Public Law 86-272, which includes an express recognition that, under the "venerable maxim *de*

minimis not curat lex ('the law cares not for trifles')," a taxpayer would not be subject to a state's taxing jurisdiction if it only had a *de minimis* connection to that state. ***Id.*** at 231. Genentech argues that Massachusetts should not be able to impose tax based on what it argues is a *de minimis* amount of property it held in Massachusetts during 1998. While the Court did not go on to give an indication of what would fall under a *de minimis* scope, it took specific note of the fact that the activity performed by the taxpayer it had held to be unprotected by Public Law 86-272 only generated .00007% of Wrigley's total sales. ***Id.*** at 235. As it so happens, the $86,774 original cost of tangible property in Massachusetts was .007% -- or 100 times that much -- of Genentech's total inventory of $148,625,645 plus the original cost of buildings and depreciable assets of $1,075,949,590 as of the end of the 1998 tax year.[10] Also, the Board has previously found similar levels of property to be sufficient to create nexus. *See* ***Universal Instruments Corp. v. Commissioner of Revenue***, Mass. ATB Findings and Reports at 1998-411 (taxpayer with $65,727 of inventory in 1983 and $86,360 of inventory in 1984).

[10] The Massachusetts property was equal to approximately .003% of all of the appellant's end of year assets of $2,906,451,261, including intangible assets.

Genentech also held title to drugs being used in an investigation by a CRO based in Massachusetts that began in 1998 with twenty-five subjects. The Board previously ruled that when a pharmaceutical company supplied CROs with drugs to be tested, it "constitute[d] the 'owning or using' of [the pharmaceutical company's] property in the Commonwealth under G.L. c. 63, § 39, for purposes other than the solicitation of orders," where the pharmaceutical company retained title to the drugs. ***Amgen, Inc. v. Commissioner of Revenue***, Mass. ATB Findings of Fact and Reports 1997-539, 559. While the Board does not adopt a bright line rule that a specified level of property or possession of clinical trial material in and of itself will create nexus in every case, a court "need not decide whether any... nonimmune activities [is] *de minimis* in isolation," ***Wrigley***, 505 U.S. at 235, and the Board ruled that Genentech's ownership of tangible property used by employees taken together with its ownership of drugs used in clinical trials was sufficient to create nexus for the 1998 tax year.[11]

[11] In ruling that the appellant's ownership of inventory and clinical trial drugs was sufficient to create nexus, the Board rejected Genentech's argument that because the activities of an independent contractor cannot be attributed for corporate excise tax nexus purposes, the activities performed by Alkermens or the CROs cannot impute nexus back to Genentech. *See* 830 CMR 63.39.1(7). It is not the activities of Alkermes or the CROs that were nexus creating; it was the ownership of the underlying property in Massachusetts itself that created nexus.

In addition to property located in Massachusetts, Genentech also employed multiple individuals who worked in the Commonwealth during the tax periods at issue. Genentech contends that the activities of these individuals were limited to the solicitation of sales of tangible property, which were approved outside of the state, and thus Massachusetts is circumscribed from asserting nexus pursuant Public Law 86-272. In ***Wrigley,*** the Court found that the phrase "solicitation of orders" in Public Law 86-272 covered "more than what is strictly essential to making requests for purchases[,]" but included activities which were "**entirely ancillary** to requests for purchases - those that serve no independent business function apart from their connection to the soliciting of orders" and not "those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force." ***Id.*** at 228-229 (emphasis in original).

The pharmaceutical industry is unique in that there are three parties who are usually involved in the purchase transaction: the doctor who prescribes a particular drug, the patient who completes the purchase of the drug from the pharmacy and ultimately uses it, and the patient's insurance company who in most cases ultimately pays for it. The Board has dealt previously at length with the

applicability of Public Law 86-272 to pharmaceutical companies in ***Amgen, Inc. v. Commissioner of Revenue***, Mass. ATB Findings of Fact and Reports 1997-539. The taxpayer, Amgen, Inc. ("Amgen"), was a California-based pharmaceutical manufacturer, which had no physical operations in Massachusetts but had a number of employees here, including "Professional Sales Representatives" ("PSRs") and "Clinical Support Specialists" ("CSSs"). ***Id.*** At 542. PSRs performed a function similar to Genentech's clinical specialists, while the CSSs were registered nurses who assisted the PSRs in their sales efforts, but who performed additional clinical services due to their increased level of expertise. ***Id.*** at 543 and 546-547.

The Board ruled that the solicitation of doctors by the PSRs was within the boundaries of Public Law 86-272. ***Id.*** at 556-557. The SJC, in upholding the Board's ruling, indicated that, because nurses may also have significant input into the purchasing decision, the PSRs solicitation of nurses and demonstration made to them, without more, could be a permitted indirect form of solicitation of orders under Public Law 86-272. ***Amgen***, 427 Mass. 357, 362, n. 5. (1998). Thus, the Board likewise ruled that the activities of Genentech's clinical specialists were

similarly protected activities within the purview of Public Law 86-272.[12]

While the activities of the PSRs in ***Amgen*** were found to be the solicitation of sales, the activities of the CSSs, which included reviewing patient charts and answering patient specific questions, exceeded the solicitation of orders. ***Id.*** at 361. In explaining its ruling, the SJC addressed Amgen's argument that the CSSs' activities were part of the overall solicitation effort:

> Amgen is misreading the proper standard for determining whether an activity is protected from the Massachusetts excise by Pub. L. 86-272. Amgen has indicated how the activities of its CSSs might tend to increase general sales. Amgen's brief even states that the activities of its sales force were exclusively dedicated to the goal of increasing orders. Amgen has not indicated how such activities increase the actual solicitation of orders. Pub. L. 86-272 protects only the latter from the Massachusetts excise. ***Id.*** at 362.

Although the activities of Genentech's MSLs and managed care division are geared toward increasing the use

[12] The Commissioner suggests that the fact that some of the solicitation of doctors took place outside of a clinical setting, such as lunch meetings and baseball outings that Genentech paid for, somehow changes the nature of the meeting into something other than the solicitation of sales. The Board recognizes that the sales profession frequently involves the social entertainment of potential customers and that meetings may take place over lunch or dinner at the seller's expense. As the Supreme Court stated in ***Wrigley***, if "[t]he purpose of an activity... [is] to ingratiate the salesman with the customer, thereby facilitating requests for purchases," it will fall within the scope of permitted solicitation. ***Wrigley***, 505 U.S. at 235. The Board found that the added social aspect of some of the outings hosted by Genentech was not outside the bounds of permitted solicitation.

of Genentech's drugs, their activities do not involve the solicitation of doctors and nurses. MSLs are individuals with specialized medical or scientific training who are not in the sales organization but who serve as "liaisons" between Genentech, clinical treatment providers, and thought leaders in the field. They did not have any sales accounts, but supported the overall sales efforts by answering technical, clinical questions from providers, meeting with thought leaders, and coordinating educational presentations. John Mastrianni and his predecessor covering Massachusetts as part of Genentech's managed care division did not call on anyone involved in clinical treatment of patients who might be in a position to prescribe drugs. Health insurance companies are not the party that chooses which drug is prescribed or the party which makes the purchase of the drug at the pharmacy, but in many cases they are the party that bears the ultimate cost of the drugs. As such, whether a drug is covered under an insurance plan and to what extent can have a material impact on whether it can be chosen as a treatment.

However, the Board did not ultimately reach the issue of whether the activities of MSLs or the managed care division exceeded the boundaries of Public Law 86-272 for each of the periods at issue as it found that the ownership

of property was sufficient to subject Genentech to Massachusetts corporate excise tax for all of the periods at issue.

II. Genentech's Production of Biologically Derived Pharmaceuticals is Manufacturing

Pursuant to G.L. c. 63, § 38(*1*), a "manufacturing corporation" is required to apportion its income to Massachusetts using a single sales factor apportionment formula. A manufacturing corporation is defined as one that is "engaged in manufacturing," which means being "engaged, in substantial part, in transforming raw or finished physical materials by hand or machinery, and through human skill and knowledge into a new product possessing a new name, nature, and adapted to a new use." ***Id.***; *See* ***Boston & Me. R.R. v. Billerica***, 262 Mass. 439, 444-445 (1928)(manufacturing is "[c]hange wrought through the application of forces directed by the human mind, which results in the transformation of some pre-existing substance or element into something different, with a new name, nature or use"). Massachusetts courts have historically "construed the phrase 'engaged in manufacturing' as having a flexible meaning that should not be narrowly restricted." ***Onex Communications Corp. v. Commissioner of Revenue***, 457 Mass. 419, 425 (2010)(citing

William F. Sullivan & Co. v. Commissioner of Revenue, 413 Mass. 576, 579 (1992) and ***Commissioner of Corps. & Taxation v. Assessors of Boston***, 324 Mass. 32, 36 (1949)).

A determination as to whether a corporation is engaged in manufacturing depends on the facts and circumstances of each taxpayer. ***Commissioner v. Houghton Mifflin Co.***, 423 Mass. 42, 45 (1997); ***William F. Sullivan & Co.*** 413 Mass at 581; ***Commissioner of Corps. & Taxation***, 324 Mass. at 733. This case-by-case analysis has prompted a large body of case law through which a variety of activities have been determined to be manufacturing. *See e.g.*, ***William F. Sullivan & Co.***, 413 Mass. at 579 (cleaning and sorting scrap metal and processing into blocks); ***Joseph T. Rossi Corp. v. Commissioner of Revenue***, 369 Mass. 178, 182 (1975)(converting standing timber into cut lumber); ***Assessors of Boston v. Commissioner of Corps. & Taxation***, 323 Mass. 730, 741-748 (1949) (roasting and grinding coffee, producing soft drinks, juice, and chocolate milk, scouring wool); ***Random House, Inc. v. Commissioner of Revenue***, Mass. ATB Findings of Fact and Reports 2012-973, 982 (creating electronic files used to print books). The Commissioner has promulgated a regulation, 830 CMR 58.2.1, which outlines certain principles derived from these cases to serve as guidelines for what constitutes manufacturing,

including, *inter alia*, that: (1) if the process involves chemical change to property rather than only physical change, it is more likely to be manufacturing; (2) if the process involves only physical change to property, the greater the degree of physical change, the more likely the process is manufacturing; and (3) a process which merely makes an item more attractive for sale without substantially altering the item is not manufacturing. 830 CMR 58.2.1(6)(b).

Genentech characterizes its activities as harvesting naturally occurring proteins that were secreted by naturally reproducing cells and selling them for human use without alteration. Thus, in the appellant's view, its activities are akin to a farmer who harvests corn or tomatoes produced by plants, which even if it is often done with the aid of heavy machinery, is not manufacturing. The Board found the appellant's analogy to farming to be facile at best.

While it is true that the proteins which comprise Genentech's drugs are naturally occurring, they certainly do not naturally occur in the environment where Genentech harvests them. Genentech scientists implanted DNA molecules into a bacteria cell or Chinese hamster ovary to genetically transform that medium to behave in ways other

than what its natural genetic code would dictate. Genentech then took the original genetically altered cells developed to produce each of their drugs and let them reproduce billions of times over, each time replicating the same strand of DNA necessary to make the desired protein.

Genentech does not take any action to replicate the cells - that is the natural action of what a cell does. In that way, the appellant argues that its activities are analogous to those in ***The Charles River Breeding Laboratories, Inc. v. State Tax Commission***, 374 Mass. 333 (1978) (***"Charles River Labs"***), which involved a taxpayer engaged in the production of laboratory animals in Massachusetts. Unlike normal animals, the animals sold by Charles River Labs were intended to be used in biomedical research and were accordingly born and raised in rigidly controlled, germ-free conditions. ***Id.*** at 334. The mice or rats introduced into the sterile environment were originally delivered via cesarean section; however, once in the environment, the animals continued to breed normally. ***Id.*** The SJC held that the breeding of these sterile animals was not manufacturing as there was no change of any substance, element, or material into something different, "[n]o matter how intricately [the breeding process was] carried on." ***Id.*** at 335.

However, the SJC added a caveat its holding, specifying that the Court "[left] to another day, if it comes, the question whether processes which alter the genetic structure of animals fall within the statutory concept of manufacturing." *Id.* n. 4. As the SJC recognized in explicitly making a distinction between the two scenarios, there is a difference between simple reproduction as a naturally occurring process and a process where something is transformed by human knowledge or skill through the means of genetic modification. Charles River Labs did not alter the animals themselves in any way; it let nature take its course, allowing the animals to procreate. Genentech did not simply identify a cell that naturally produces a certain desirable protein and allow that cell to reproduce in a controlled environment. Genentech took a naturally occurring organism and modified its DNA, physically transforming it into something that does not occur in nature.

Moreover, the initial implantation of the DNA is not the end of the manufacturing steps in the production of Genentech drugs. This is because the genetically modified replicated E. coli or Chinese hamster ovary cell is of no medical use to a patient until the protein of interest is extracted and purified. Genentech likens this process of

harvesting of protein from a cell to the act of farming plants from the soil and further argued that, because there is no physical transformation to the protein itself, the process is not tantamount to manufacturing. However, in order to extract the expressed proteins, Genentech in many instances must disrupt or break down the cell walls, effectively breaking the cell apart and releasing all of its contents. Regardless of whether cells must be disrupted, in every case, the appellant must take the cell mixture and through physical change separate out a product through purification and separation into something fit for consumption. The Board therefore found and ruled Genentech's processes, from the creation and implanting of genes through harvesting and purification, constituted manufacturing.

Genentech also points to a line of cases which involved mining and quarry operations that were found not to be manufacturing, including ***Tilcon-Warren Quarries, Inc. v. Commissioner of Revenue***, 392 Mass. 670 (1984) and ***Se. Sand and Gravel v. Commissioner of Revenue***, 384 Mass. 794 (1981). The taxpayer in ***Tilcon-Warren Quarries, Inc.*** blasted rock from its quarries using dynamite, which it then crushed into smaller pieces, sorted by size, or crushed further into sand. 392 Mass. at 671 - 672. Quoting

the observation of the Virginia Supreme Court that in the case of quarrying and crushing stone, "the sand is still sand and the rock is still rock" after processing, the SJC found that there was not sufficient change to render the crushing to be manufacturing. ***Id.*** at 673 (quoting ***Solite Corp. v. County of King George,*** 220 Va. 661, 663 (1980)).

The Board found that Genentech's disruption of cells and separation of specific proteins through an extensive purification process to be completely different from quarrying stone. Instead of breaking down an extant substance into smaller pieces where the intrinsic properties of the substance remain the same, Genentech's purification process takes a substance - - the cell mixture solution - - and subjects it to physical change to derive a new product fit for human use - - the purified protein. Such processes have been found on multiple occasions to be manufacturing. *See e.g.,* ***Joseph T. Rossi v. State Tax Comm'n,*** 369 Mass. at 182 (1975) (transforming standing timber into usable lumber is manufacturing); ***Noreast Fresh, Inc. v. Commissioner of Revenue,*** 50 Mass. App. Ct. 352, 357 (2000) (processing of bulk lettuce, cabbage, and carrots into cut pieces which are rinsed, sanitized, and mixed to make salad is manufacturing as it resulted in a new article and a new use); ***Golden Eye Seafood, Inc. v. State Tax***

Comm'n Mass. ATB Findings of Fact and Reports 1980-268, 270 (processing of whole, scaled fish which is inedible into fillets which are saleable for human consumption is manufacturing). Accordingly, the Board found and ruled that Genentech was engaged in manufacturing activities.

III. Genentech's Measure of Substantial Manufacturing Activity May Not Include Proceeds from Redemption or Maturity of Short-Term Securities

A corporation is only required to use a single sales factor apportionment formula if it is "substantially engaged" in manufacturing activities. G.L. c. 63, § 38(*l*)(1). Manufacturing activities will be deemed to be substantial if any one of the following four numeric tests are met, with a fifth catch-all provision:

> (1) 25% or more of its gross receipts are derived from the sale of manufactured goods that it manufactures;
> (2) 25% or more of its payroll is paid to employees working in its manufacturing operations and 15% or more of its gross receipts are derived from the sale of manufactured goods that it manufactures;
> (3) 25% or more of its tangible property is used in its manufacturing operations and 15% or more of its gross receipts are derived from the sale of manufactured goods that it manufactures;
> (4) 35% or more of its tangible property is used in its manufacturing operations; or
> (5) the corporation's manufacturing activities are deemed substantial under relevant regulations promulgated by the commissioner. *Id.*

During the periods at issue, the parties agreed that the proportion of Genentech's property and payroll involved in manufacturing were both below the requisite thresholds.

Accordingly, the determination rests on whether 25 percent or more of Genentech's gross receipts were derived from the sale of goods that it manufactured ("Receipts Test"). The disagreement between the parties hinges on what is included in the definition of "gross receipts" for purposes of the Receipts Test, as no definition of "gross receipts" is given in the statute.

The Commissioner promulgated 830 CMR 58.2.1, which outlines the qualifications of a manufacturing corporation for property tax purposes, which hews to the same tests, but for the fact that only the taxpayer's Massachusetts activities are included in the analysis. Pursuant to 830 CMR 63.38.1(10)(b)(3), the percentage of receipts derived from the sale of manufactured goods for purposes of the Receipts Test is to be determined using the receipts fraction for property tax purposes delineated in 830 CMR 58.2.1, except that gross receipts attributable to manufacturing performed outside of Massachusetts are to be included in both the numerator and denominator of the receipts fraction.

The denominator of the receipts fraction defined in 830 CMR 58.2.1(e)(1)(b) for property tax purposes is the sum of (1) gross receipts derived from the sales of products manufactured in Massachusetts; (2) gross receipts

derived from all non-manufacturing business activities in Massachusetts; and (3) the sum of all gross interest, dividends, and capital gains, except those gains attributable to an extraordinary event, multiplied by the taxpayer's Massachusetts apportionment.[13] Thus, by explicitly limiting the third category of includable receipts to "interest, dividends, and capital gains," the applicable regulation clearly dictates that only the interest and dividends earned by Genentech through the use of its capital are to be taken into account as a receipt, not the return of that underlying capital itself.

Genentech argues that this is inconsistent with G.L. c. 63, § 38(*l*), which only broadly states that activity should be measured against all "gross receipts." In general, "[w]here a regulation is consistent with the statute which it interprets and represents a reasonable interpretation of that statute, the administrative interpretation is entitled to deference." ***Holyoke Gas and***

[13] The appellant correctly points out that if the direction of 830 CMR 63.38.1(10) to add non-Massachusetts manufacturing receipts to the numerator and denominator to the gross receipts fraction described in 830 CMR 58.2.1(d) is followed literally, the result is to compare manufacturing receipts everywhere to the sum of manufacturing receipts everywhere, non-manufacturing activities in Massachusetts, and investment income apportioned to Massachusetts. The Commissioner's approach during the course of the audit appears to have consistently been to examine Genentech's manufacturing receipts everywhere compared to its total business receipts everywhere. As Genentech's manufacturing receipts exceeded 25% under either of those two measures, the Board did not reach the question of whether there is any unfairness inherent in the Commissioner's regulation to out-of-state taxpayers by only including Massachusetts non-manufacturing receipts in the denominator.

Electric Dept. v. Commissioner of Revenue, Mass. ATB Findings of Fact and Reports 2002-262, 277-78. The burden is on the party challenging the regulation to demonstrate that it is invalid, such as where it is in conflict with the statute or exceeds the authority of the agency which promulgated it. ***Entergy Nuclear Generation Co. v. Department of Envtl. Protection***, 459 Mass. 319, 329 (2011).

The Legislature created a specially weighted apportionment formula for manufacturing corporations, including the Receipts Test by amending G.L. c. 63, § 38 on November 28, 1995. *See* St. 1995, c. 280, § 2. The formula was to be phased in for manufacturers beginning with the tax year beginning on or after January 1, 1996. ***Id.*** The Commissioner's first version of a regulation under G.L. c. 63, § 38, promulgated in August 1995, predated that amendment by a few months and therefore did not address the issue. *See* 771 Mass. Reg. 145 (Aug. 11, 1995). In February 1999, the Commissioner issued a new version of the regulation specifically in order to "take into account the single sales factor apportionment provisions of St. 1995, c. 280." 862 Mass. Reg. 95 (Feb. 5, 1999). The revised regulation contained the direction to rely on the tests outlined in 830 CMR 58.2.1, which had been in place for a number of years, and was applied retroactively to 1996. ***Id.***

Therefore, the Board ruled that the Commissioner's regulations were due the deference of a contemporaneously promulgated regulation and that the regulation is consistent with the Receipts Test.[14]

The appellant nevertheless argues that the Board should disregard the Commissioner's regulation because as a matter of statutory construction, "gross receipts" must be given its plain meaning to encompass revenue from any source. Furthermore, the appellant argues that G.L. c. 63, § 38(*l*) must be construed in harmony with G.L. c. 63, § 38(f), which provides that the sales factor includes all "gross receipts" less "gross receipts from the maturity, redemption, sale, exchange or other disposition of securities" and thus by inference every time "gross receipts" is mentioned in G.L. c. 63, § 38 it would include all gross receipts from the sale of securities.

Where the language of a statute is clear and unambiguous, it is conclusive as to legislative intent and courts will enforce the statute according to its plain wording; however, this is only the case so long as its

[14] The Board rejected Genentech's contention that the February 1999 version of 830 CMR 63.38.1 can only extend to periods after its promulgation, despite the express provision for its retroactive application. The amendment to the regulation did not introduce any substantive changes to the existing statute, but merely provided additional clarification. *See Cohen v. Board of Water Commissioners*, 411 Mass. 744,752 (1992).

application would not lead to an absurd result. ***City of Worcester v. College Hill Props., LLC***, 465 Mass. 134, 138 (2013); ***Pyle v. School Comm. of S. Hadley***, 423 Mass. 283, 285 (1996). The Board found and ruled that the obvious purpose inherent in comparing a taxpayer's manufacturing property, payroll, and sales to its overall property, payroll, and sales to test whether its manufacturing activity is "substantial" is to use those figures as a proxy to represent what portion of the taxpayer's overall business activities comprises manufacturing. *See* ***First Marblehead Corp. v. Commissioner of Revenue***, Mass. ATB Findings of Fact and Reports 2013-241, 280 (portion of taxpayer's annual receipts that are derived from manufacturing is a reasonable reflection of the amount of available resources that a taxpayer devotes to the activity).

If the Board were to follow Genentech's approach for the 2004 tax year as an example, the appellant would have generated $39,226,839,298 in gross receipts, of which only $4,578,096,817 came from ordinary business income, such as revenue from the sale of drugs, royalties from the license of intellectual property, contract revenue, and investment income in the form of interest, dividends, and capital gains. The remainder of those "gross receipts" would have

been derived from redeeming money market funds or commercial paper for their cash equivalent, receipts that were not included for accounting purposes in the measures of revenue reported to shareholders or included in the computation of taxable income. Using these figures as a proxy would mean that approximately 88% of Genentech's overall business activities in 2004 consisted of a handful of employees in the treasury department managing Genentech's day-to-day cash flow. The Board found and ruled that including these receipts, therefore, would lead to the conclusion that instead of being in the business of developing and selling drugs, Genentech's primary activity was acting as a cash management company in the business of purchasing and selling money market funds and commercial paper. The Board declined to reach this absurd result.

The appellant urged the Board to follow the California Supreme Court's decision in ***Microsoft Corporation v. Franchise Tax Board***, 39 Cal. 4th 750 (2006). The taxpayer, Microsoft Corporation ("Microsoft"), was a large computer software company based in Seattle, which had a treasury function, similar to Genentech's, that invested its excess cash in short-term securities. ***Id.*** at 757. Microsoft argued that its gross proceeds from redemption and maturity of those securities should be included in its sales factor

denominator for California corporate income tax apportionment purposes, which by statute was defined to include all "gross receipts." ***Id.*** Because Microsoft's treasury function was located outside of California, inclusion of the receipts would have had the effect of decreasing its California sales factor from 11 percent to 3 percent and cutting its tax nearly in half. ***Id.*** As the appellant notes, the California Supreme Court found that while the statute was "not unambiguous," the term "gross receipts" should be deemed to include the gross proceeds from redemption or maturity of securities. ***Id.*** at 759.

However, in that case, the Court was "unable to accept, even for a moment, the notion that" a significant portion of a taxpayer's entire unitary business activities "should be attributed to **any** single state solely because it is the center of working capital investment activities that are clearly only an incidental part of one of America's largest, and most widespread, businesses." ***Id.*** at 765 (emphasis in original)(quoting ***Appeal of Pacific Telephone and Telegraph***, 1978 Cal. Tax LEXIS 91, *30 (1978)). The fact that "modern corporate treasury departments... are qualitatively different from the rest of a corporation's business and [their] typical margins may be quantitatively several orders or magnitude different from the rest of a

corporations' business..." led to a situation where Microsoft's short-term investments produced less than 2 percent of its income but accounted for 73 percent of all gross receipts. *Id.* at 768, 765. Accordingly, the Court held that inclusion of the receipts would result in an overly distorted measure of the taxpayer's sales attributable to California and invoked a statute that authorized the use of an alternative apportionment formula for a specific taxpayer, which in Microsoft's case meant only including net receipts to the extent the redemption or maturity price was greater than the original purchase price.[15] *Id.* at 771.

The Board agreed with California in so far as its conclusion that labeling proceeds from the daily redemption of short-term securities for their cash equivalent is distortive. Thus, in accordance with the applicable regulation and the legislative purpose behind the Receipts Test, the Board found and ruled that only interest, dividends, and capital gains generated by investing activity are properly included in the denominator Receipts

[15] After the California Supreme Court's holding in *Microsoft Corp.*, the state's legislature amended the relevant statute to make clear that "[r]epayment, maturity, or redemption of the principal of a loan, bond, mutual fund, certificate of deposit, or similar marketable instrument" and "[a]mounts received from transactions in intangible assets held in connection with a treasury function" did not constitute gross receipts, which it explicitly stated "constitute[d] [a] clarifying, nonsubstantive [change]." Cal. Rev. & Tax. Code § 25120(f).

Test. Accordingly, as greater than 25 percent of Genentech's receipts under that measure were derived from the sale of manufactured drugs, Genentech was required by G.L. c. 63, § 38(*l*) to apportion its income using a single sales factor.

IV. Investment Tax Credits and Research and Development Tax Credits

Massachusetts provides a credit against corporate excise for corporations engaged in manufacturing which purchase eligible tangible property placed in service in Massachusetts or which undertake research and development activities in the Commonwealth. G.L. c. 63, §§ 31A and 38M. The credits are calculated as a fixed percentage of the related qualified expenditure. *Id.* These incentives are available to any corporations which meet the statutory requirements, regardless of their place of domicile; however, in order to claim the credit, the underlying activity must take place in Massachusetts. *Id.* The appellant argued that this renders the Massachusetts ITC and R&D Credit regimes to be in violation of the Commerce Clause of the U.S. Constitution by unfairly discriminating against interstate commerce. Therefore, Genentech asserts that it should have been entitled to claim Massachusetts ITC and R&D Credits for its activities conducted in

California that would otherwise have qualified for a credit if conducted in Massachusetts.

The Board recently found this argument to be unpersuasive in ***Random House, Inc. v. Commissioner of Revenue***, Mass. ATB Findings of Fact and Reports 2012-973 ("***Random House***"). There the taxpayer, like Genentech, had made otherwise qualifying investments outside of the Commonwealth and had also argued that the ITC was unconstitutional because it only extended benefits to companies that made qualifying investments in Massachusetts. ***Id.*** at 980. After extensive analysis, the Board ruled ITC to be constitutional, ***Id.*** at 999, a ruling whose logic naturally extends to R&D Credits and which the Board reaffirms today. As the Board explained in ***Random House***, "the crucial factor in a Dormant Commerce Clause analysis is whether the differential treatment is imposed, not simply on an out-of-state taxpayer, but on interstate commerce, which entails the movement of goods and services." ***Id.*** at 998-999. The credit was denied to Random House "because it failed to make a qualifying one-time investment in Massachusetts, not because it moved its goods or services across state lines." ***Id.*** at 999. Massachusetts provides a credit to corporations offsetting the cost of making a qualifying investment or undertaking qualifying

research in Massachusetts, but does not disparately treat taxpayers in the marketplace or otherwise distort interstate commerce in favor of in-state businesses.

V. Conclusion

Based on the foregoing, the Board found and ruled that the appellant was not entitled to an abatement of corporate excise as assessed by the Commissioner and it therefore issued Decisions for the appellee in these appeals.

THE APPELLATE TAX BOARD

By: _____
Thomas W. Hammond, Jr., Chairman

A true copy,

Attest: _____
Asst. Clerk of the Board

Massachusetts General Laws Annotated
Part I. Administration of the Government (Ch. 1-182)
Title IX. Taxation (Ch. 58-65c)
Chapter 63. Taxation of Corporations (Refs & Annos)

M.G.L.A. 63 § 31A

§ 31A. Investment credit for certain corporations; limitations

Effective: July 1, 2014
Currentness

(a) A manufacturing corporation, or a business corporation engaged primarily in research and development, which has been deemed to be such under section forty-two B, or a corporation primarily engaged in agriculture or commercial fishing, shall be allowed a credit as hereinafter provided against its excise due under this chapter. The amount of such credit shall be one per cent of the cost or other basis for federal income tax purposes of qualifying tangible property acquired, constructed, reconstructed, or erected during the taxable year, after deduction therefrom of any federally authorized tax credit taken with respect to such property. Qualifying property shall be tangible personal property and other tangible property including buildings and structural components of buildings acquired by purchase, as defined under section one hundred and seventy-nine (d) of the Federal Internal Revenue Code as amended [1] and in effect for the taxable year is not taxable under chapter sixty A; used by the corporation in the commonwealth; situated in the commonwealth on the last day of the taxable year; and which (1) is depreciable under section one hundred and sixty-seven of said Code [2] and has a useful life of four years or more, or (2) is considered recovery property under section one hundred and sixty-eight of said Code. [3]

A manufacturing corporation, or a business corporation engaged primarily in research and development, which has been deemed to be such under section forty-two B, or a corporation primarily engaged in agriculture or commercial fishing, shall be allowed a credit against its excise due under this chapter for tangible personal property leased pursuant to an operating lease as hereinafter provided. The amount of such credit afforded to a lessee corporation with respect to such tangible personal property shall be one percent of the lessor's adjusted basis in the property for federal income tax purposes at the beginning of the lease term, multiplied by a fraction, the numerator of which shall be the number of days of the taxable year during which the lessee corporation leases the tangible personal property and the denominator of which shall be the number of days in the useful life of such property. Such useful life shall be the same as that used by the lessor for depreciation purposes when computing federal income tax liability. An operating lease shall be any contract or agreement to lease or rent or for a license to use such property provided that (i) said lease does not constitute a purchase as defined under section one hundred and seventy-nine (d) of the Code, as amended and in effect for the taxable year, (ii) such property is not taxable under chapter sixty A, (iii) such property is used by the lessee corporation in the commonwealth, (iv) such property is situated in the commonwealth throughout the entire lease term, and (v) such property (1) is depreciable by the lessor under section one hundred and sixty-seven of said Code and has a useful life of four years or more, or (2) is considered recovery property under section one hundred sixty-eight of said Code. Such credit shall not be available to a lessee if such lessor has previously received a credit with respect to the leased tangible personal property. The commissioner shall by regulation require such documentation of the lessor and lessee as to substantiate the credit claimed by this section.

(b) A corporation shall not be allowed a credit under paragraph (a) with respect to tangible personal property and other tangible property, including buildings and structural components of buildings, which it leases as a lessor. For the purposes of the preceding sentence, any contract or agreement to lease or rent or for a license to use such property shall be considered a lease.

(c) The credit allowed under this section for any taxable year shall not reduce the excise to less than the amount due under section thirty-nine (b) or sixty-seven and under any act in addition thereto.

(d) A corporation may elect to deduct the amount allowable under section thirty-eight D or the credit under this section, but not both. Any such election must be made on or before the due date of filing the return, including any extension of time and shall be irrevocable.

(e) With respect to property which is disposed of or ceases to be in qualified use prior to the end of the taxable year in which the credit is to be taken, the amount of the credit shall be that portion of the credit provided for in paragraph (a) which represents the ratio which the months of qualified use bear to the months of useful life. If property on which credit has been taken is disposed of or ceases to be in qualified use prior to the end of its useful life, the difference between the credit taken and the credit allowed for actual use must be added back as additional taxes due in the year of disposition; provided, however, if such property is disposed of or ceases to be in qualified use after it has been in qualified use for more than twelve consecutive years, it shall not be necessary to add back the credit, as provided in this paragraph. The amount of credit allowed for actual use shall be determined by multiplying the original credit by the ratio which the months of qualified use bear to the months of useful life. For the purposes of this paragraph, useful life of property shall be the same as that used by the corporation for depreciation purposes when computing federal income tax liability.

(f) A corporation renting or leasing tangible property otherwise qualifying for the credit under this section from a regional business development corporation or authority authorized under chapter forty D or a regional business development corporation organized as a non-profit corporation under any special act shall be deemed to have acquired such property by purchase as defined under Sec. 179(d) of the Federal Internal Revenue Code, as amended and in effect for the taxable year, for the purposes of this section and shall be eligible for the credit under paragraph (a). The amount of such credit shall be one per cent of the value of qualifying property leased and placed in qualified use during the taxable year. Such value shall be the cost of such property to the regional business development corporation and the books and records of such corporation shall for the purposes of this section be open to the commissioner for inspection. For the purposes of this section, a termination or cessation of such rental or lease for any reason other than a transfer of ownership of such property to the lessee shall be considered a disposition of such property. No further credit shall be allowed to such lessee or any successor corporation, as the case may be, on account of such property in the event of successive rentals or leases, replacement, alteration or change of the property rented or leased; transfer of ownership of such property to the lessee; or the merger, consolidation or other reorganization of such lessee.

(g) Any corporation entitled to a credit for any taxable year in accordance with the provisions of paragraphs (a) to (f), inclusive, may carry over and apply to its excise for any one or more of the next succeeding three taxable years, the portion, as reduced from year to year, of its credit which exceeds its excise for the taxable year.

(h) Any corporation entitled to a credit for any taxable year under this section shall apply it only to its excise for any of the eligible taxable years.

(i) A manufacturing corporation, or a business corporation engaged primarily in research and development, which has been deemed to be such under section forty-two B, or a corporation primarily engaged in agriculture or commercial fishing, shall be allowed a credit as hereinafter provided against its excise due under this chapter. The amount of such credit shall be three percent of the cost or other basis for federal income tax purposes of qualifying tangible property acquired, constructed, reconstructed, or erected during the taxable year, after deduction therefrom of any federally authorized tax credit taken with respect to such property. Qualifying property shall be tangible personal property and other tangible property including buildings and structural

components of buildings acquired by purchase, as defined under section one hundred and seventy-nine (d) of the Federal Internal Revenue Code as amended and in effect for the taxable year is not taxable under chapter sixty A; used by the corporation in the commonwealth; situated in the commonwealth on the last day of the taxable year; and which is depreciable under section one hundred and sixty-seven of said Code and has a useful life of four years or more.

A manufacturing corporation, or a business corporation engaged primarily in research and development, which has been deemed to be such under section forty-two B, or a corporation primarily engaged in agriculture or commercial fishing, shall be allowed a credit against its excise due under this chapter for tangible personal property leased pursuant to an operating lease as hereinafter provided. The amount of such credit afforded to a lessee corporation with respect to such tangible personal property shall be three percent of the lessor's adjusted basis in the property for federal income tax purposes at the beginning of the lease term, multiplied by a fraction, the numerator of which shall be the number of days of the taxable year during which the lessee corporation leases the tangible personal property and the denominator of which shall be the number of days in the useful life of such property. Such useful life shall be the same as that used by the lessor for depreciation purposes when computing federal income tax liability. An operating lease shall be any contract or agreement to lease or rent or for a license to use such property provided that (i) said lease does not constitute a purchase as defined under section one hundred and seventy-nine (d) of the Code, as amended and in effect for the taxable year, (ii) such property is not taxable under chapter sixty A, (iii) such property is used by the lessee corporation in the commonwealth, (iv) such property is situated in the commonwealth throughout the entire lease term, and (v) such property is depreciable by the lessor under section one hundred and sixty-seven of said Code and has a useful life of four years or more. Such credit shall not be available to a lessee if such lessor has previously received a credit with respect to the leased tangible personal property. The commissioner shall by regulation require such documentation of the lessor and lessee as to substantiate the credit claimed by this section.

(j) A corporation renting or leasing tangible property otherwise qualifying for the credit under this section from a regional business development corporation or authority authorized under chapter forty D or a regional business development corporation organized as a non-profit corporation under any special act shall be deemed to have acquired such property by purchase as defined under Sec. 179(d) of the Federal Internal Revenue Code, as amended and in effect for the taxable year, for the purposes of this section and shall be eligible for the credit under paragraph (a). The amount of such credit shall be three percent of the value of qualifying property leased and placed in qualified use during the taxable year. Such value shall be the cost of such property to the regional business development corporation and the books and records of such corporation shall for the purposes of this section be open to the commissioner for inspection. For the purposes of this section a termination or cessation of such rental or lease for any reason other than a transfer of ownership of such property to the lessee shall be considered a disposition of such property. No further credit shall be allowed to such lessee or any successor corporation, as the case may be, on account of such property in the event of successive rentals or lease, replacement, alteration or change of the property rented or leased; transfer of ownership of such property to the lessee; or the merger, consolidation or other reorganization of such lessee.

(k) Paragraphs (a) and (f) shall not be available for the taxable years ending on or after December 31, 1993.

(*l*) Paragraphs (i) and (j) shall be available only for the taxable years ending on or after December 31, 1993.

(m) For the purposes of this section, the provisions of paragraphs (b), (c), (d), (e), (g), and (h) shall apply to paragraphs (i) and (j) as appropriate.

Credits

Added by St.1970, c. 634, § 2. Amended by St.1973, c. 752, § 3; St.1977, c. 919, § 1; St.1982, c. 658, § 3; St.1988, c. 202, §§ 12, 13; St.1993, c. 19, § 17; St.1994, c. 60, §§ 83 to 85; St.1996, c. 151, § 207; St.1999, c. 127, § 88; St.2003, c. 26, §§ 205,

206, eff. July 1, 2003; St.2003, c. 141, § 25, eff. Nov. 26, 2003; St.2005, c. 163, §§ 23 to 25, eff. Dec. 8, 2005; St.2008, c. 173, § 43, eff. July 3, 2008; St.2014, c. 165, §§ 107, 108, eff. July 1, 2014.

Notes of Decisions (20)

Footnotes

1 26 U.S.C.A. § 179(d).

2 26 U.S.C.A. § 167.

3 26 U.S.C.A. § 168.

M.G.L.A. 63 § 31A, MA ST 63 § 31A

Current through Chapter 33 of the 2015 1st Annual Session

End of Document

Massachusetts General Laws Annotated
Part I. Administration of the Government (Ch. 1-182)
Title IX. Taxation (Ch. 58-65c)
Chapter 63. Taxation of Corporations (Refs & Annos)

M.G.L.A. 63 § 38

§ 38. Determination of net income derived from business carried on within commonwealth

Effective: January 1, 2014 to December 30, 2018
Currentness

The commissioner shall determine the part of the net income of a business corporation derived from business carried on within the commonwealth as follows:

(a) Net income as defined in section thirty of this chapter adjusted as follows shall constitute taxable net income:

(1) Ninety-five per cent of dividends, exclusive of distributions in liquidation, included therein shall be deducted other than dividends from or on account of the ownership of:

(i) shares in a corporate trust, as defined in section 1 of chapter 62, to the extent such dividends represent tax-free earnings and profits, as defined in section 8 of chapter 62, as in effect on December 31, 2008.

(ii) deemed distributions and actual distributions, except actual distributions out of previously taxed income, from a DISC which is not a wholly owned DISC, or

(iii) any class of stock, if the corporation owns less than fifteen per cent of the voting stock of the corporation paying such dividend.

(2) Long-term capital gains realized and long-term capital losses sustained from the sale or exchange of intangible property affected under the provisions of the Federal Internal Revenue Code, as amended, and in effect for taxable years ended on or before December thirty-first, nineteen hundred and sixty-two, shall not be included in any part therein.

<[Subsection (b) applicable as provided by 2013, 46, Sec. 84.]>

(b) If the corporation does not have income from business activity which is taxable in another state, the whole of its taxable net income, determined under the provisions of subsection (a), shall be allocated to this commonwealth. For purposes of this section, a corporation is taxable in another state if (1) in that state such corporation is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that state has jurisdiction to subject such corporation to a net income tax regardless of whether, in fact, the state does or does not. Notwithstanding any other provision of this section, the portion of the taxable net income of a corporation that a non-domiciliary state is prohibited from taxing under the Constitution of the United States shall be allocated in full to the commonwealth if the commercial domicile of the corporation is in the commonwealth.

(c) If a corporation, other than a defense corporation as described in subsection (k), a manufacturing corporation as described in subsection (l), or a mutual fund service corporation to the extent of its mutual fund sales as described in subsection (m), has income from business activity which is taxable both within and without this commonwealth, its taxable net income, as determined under the provisions of subsection (a), shall be apportioned to this commonwealth by multiplying said taxable net income by a fraction, the numerator of which is the property factor plus the payroll factor plus twice times the sales factor, and the denominator of which is four.

(d) The property factor is a fraction, the numerator of which is the average value of the corporation's real and tangible personal property owned or rented and used in this commonwealth during the taxable year and the denominator of which is the average value of all the corporation's real and tangible personal property owned or rented and used during the taxable year. Property owned by the corporation shall be valued at its original cost. Property rented by the corporation shall be valued at eight times the net annual rental rate, provided such rate reflects the fair rental value of the property as of the date of the rental agreement. Net annual rental rate is the annual rental rate paid by the corporation less any annual rental rate received by the corporation from sub-rentals.

The average value of property shall be determined by averaging the values at the beginning and the end of the taxable year, but the commissioner may require the averaging of monthly values during the taxable year if reasonably required to reflect properly the average value of the corporation's property. For the purpose of this subsection leaseholds and leasehold improvements, whether located within or without the commonwealth, shall be included within the meaning of real and tangible personal property.

(e) The payroll factor is a fraction, the numerator of which is the total amount paid in this commonwealth during the taxable year by the corporation for compensation, and the denominator of which is the total compensation paid everywhere during the taxable year.

The payroll factor for a manufacturing corporation or a business corporation engaged primarily in research and development, which has been deemed to be such under the provisions of section forty-two B, is a fraction the numerator of which is the lesser of the following amounts:--

(i) the total amount paid in this commonwealth by the corporation for compensation during the taxable year; or

(ii) the greater of (a) the total amount paid in this commonwealth by the corporation for compensation during the taxable year ended in the year nineteen hundred and seventy-two increased by five per cent per year for each taxable year subsequent to the taxable year ended in nineteen hundred and seventy-two; or (b)(1) in taxable years ending on or after December thirty-first, nineteen hundred and eighty-two and before December thirty-first, nineteen hundred and eighty-three, seventy-five per cent of the total amount paid in this commonwealth by the corporation for compensation,

(2) in taxable year ending on or after December thirty-first, nineteen hundred and eighty-three and before December thirty-first, nineteen hundred and eighty-four, eighty per cent of the total amount paid in this commonwealth by the corporation for compensation, (3) in taxable year ending on or after December thirty-first, nineteen hundred and eighty-four, and before December thirty-first, nineteen hundred and eighty-five, ninety per cent of the total amount paid in this commonwealth by the corporation for compensation, and (4) in taxable years ending on or after December thirty-first, nineteen hundred and eighty-five and thereafter, the total amount paid in this commonwealth by the corporation for compensation.

The denominator of the payroll factor for such corporation shall be adjusted for compensation paid in this commonwealth to include in total compensation paid everywhere only that amount for compensation paid in this commonwealth which is equal to the amount included in the numerator as determined under (i) and (ii) in this subsection.

Notwithstanding the provisions of this subsection, a corporation shall be eligible for the credit provided for in section thirty-one C. For the purposes of determination of the credit under section thirty-one C, the total amount of compensation paid in this commonwealth by the corporation for the taxable year shall be allowed.

As used in this subsection, "compensation" means wages, salaries, commissions, and any other form of remuneration paid to employees for personal services. Compensation is paid in this commonwealth if:

1. the employee's service is performed entirely within this commonwealth; or

2. the employee's service is performed both within and without this commonwealth, but the service performed without this commonwealth is incidental to the employee's service within this commonwealth; or

3. some of the service is performed in this commonwealth and (i) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in this commonwealth, or (ii) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the employee's residence is in this commonwealth.

<[Subsection (f) applicable as provided by 2013, 46, Sec. 84.]>

(f) The sales factor is a fraction, the numerator of which is the total sales of the corporation in the commonwealth during the taxable year, and the denominator of which is the total sales of the corporation everywhere during the taxable year.

As used in this subsection, unless specifically stated otherwise, "sales" shall mean all gross receipts of the corporation, including deemed receipts from transactions treated as sales or exchanges under the Code, except interest, dividends and gross receipts from the maturity, redemption, sale, exchange or other disposition of securities; provided, however, that "sales" shall not include gross receipts from transactions or activities to the extent that a non-domiciliary state would be prohibited from taxing the income from such transactions or activities under the Constitution of the United States. Sales of tangible personal property are in the commonwealth if:--

(1) the property is delivered or shipped to a purchaser within the commonwealth regardless of the f.o.b. point or other conditions of the sale; or

(2) the corporation is not taxable in the state of the purchaser and the property was not sold by an agent or agencies chiefly situated at, connected with or sent out from premises for the transaction of business owned or rented by the corporation outside the commonwealth. "Purchaser", as used in clauses (1) and (2) shall include the United States government.

Sales, other than sales of tangible personal property, are in the commonwealth if the corporation's market for the sale is in the commonwealth. The corporation's market for a sale is in the commonwealth and the sale is thus assigned to the commonwealth for the purpose of this section:--

(1) in the case of sale, rental, lease or license of real property, if and to the extent the property is located in the commonwealth;

(2) in the case of rental, lease or license of tangible personal property, if and to the extent the property is located in the commonwealth;

(3) in the case of sale of a service, if and to the extent the service is delivered to a location in the commonwealth;

(4) in the case of lease or license of intangible property, including a sale or exchange of such property where the receipts from the sale or exchange derive from payments that are contingent on the productivity, use or disposition of the property, if and to the extent the intangible property is used in the commonwealth; and

(5) in the case of the sale of intangible property, other than as provided in clause (4), where the property sold is a contract right, government license or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area, if and to the extent that the intangible property is used in or otherwise associated with the commonwealth; provided, however, that any sale of intangible property, not otherwise described in this clause or clause (4), shall be excluded from the numerator and the denominator of the sales factor.

For the purposes of this subsection: (1) in the case of sales, other than sales of tangible personal property, if the state or states to which sales should be assigned cannot be determined, it shall be reasonably approximated; (2) in the case of sales other than sales of tangible personal property if the taxpayer is not taxable in a state to which a sale is assigned, or if the state or states to which such sales should be assigned cannot be determined or reasonably approximated, such sale shall be excluded from the numerator and denominator of the sales factor; (3) the corporation shall be considered to be taxable in the state of the purchaser if tangible personal property is delivered or shipped to a purchaser in a foreign country; (4) sales of tangible personal property to the United States government or any agency or instrumentality thereof for purposes of resale to a foreign government or any agency or instrumentality thereof are not sales made in the commonwealth; (5) in the case of sale, exchange or other disposition of a capital asset, as defined in paragraph (m) of section 1 of chapter 62, used in a taxpayer's trade or business, including a deemed sale or exchange of such asset, "sales" shall be measured by the gain from the transaction; (6) "security" shall mean any interest or instrument commonly treated as a security as well as other instruments which are customarily sold in the open market or on a recognized exchange, including, but not limited to, transferable shares of a beneficial interest in any corporation or other entity, bonds, debentures, notes and other evidences of indebtedness, accounts receivable and notes receivable, cash and cash equivalents including foreign currencies and repurchase and futures contracts; (7) in the case of a sale or deemed sale of a business, the term "sales" shall not include receipts from the sale of the business "goodwill" or similar intangible value, including, without limitation, "going concern value" and "workforce in place"; (8) to the extent authorized under the life sciences tax incentive program established by section 5 of chapter 23*I*, a certified life sciences company may be deemed a research and development corporation for purposes of exemptions under chapters 64H and 64*I*; and (9) in the case of a business deriving receipts from operating a gaming establishment or otherwise deriving receipts from conducting a wagering business or activity, income-producing activity shall be considered to be performed in the commonwealth to the extent that the location of wagering transactions or activities that generated the receipts is in the commonwealth.

Notwithstanding the foregoing, mutual fund sales as defined in subsection (m), other than the sale of tangible personal property, shall be assigned to the commonwealth to the extent that shareholders of the regulated investment company are domiciled in the commonwealth as follows:

(a) by multiplying the taxpayer's total dollar amount of sales of such services on behalf of each regulated investment company by a fraction, the numerator of which shall be the average of the number of shares owned by the regulated investment company's

shareholders domiciled in the commonwealth at the beginning of and at the end of the regulated investment company's taxable year that ends with or within the taxpayer's taxable year and the denominator of which shall be the average of the number of shares owned by the regulated investment company shareholders everywhere at the beginning of and at the end of the regulated investment company's taxable year that ends with or within the taxpayer's taxable year.

(b) A separate computation shall be made to determine the sale for each regulated investment company, the sum of which shall equal the total sales assigned to the commonwealth.

The commissioner shall adopt regulations to implement this subsection. Nothing in this subsection shall limit the commissioner's authority under subsection (j).

(g) In a case where only two of the foregoing three factors are applicable, the taxable net income of the corporation shall be apportioned by a fraction, the numerator of which is the remaining two factors with their respective weights and the denominator of which is the number of times that such factors are used in the numerator. If only one of the three factors is applicable, the taxable net income of the corporation shall be apportioned solely by that factor. A factor shall not be deemed to be inapplicable merely because the numerator of the factor is zero. A factor shall not be applicable if the denominator of the factor is less than ten per cent of one third of the taxable net income or if it is otherwise determined to be insignificant in producing income.

(h) If a corporation maintains an office, warehouse or other place of business in a state other than this commonwealth for the purpose of reducing its tax under this chapter, the commissioner shall, in determining the amount of taxable net income apportionable to this commonwealth, adjust any factor to properly reflect the amount which the factor ought reasonably to assign to this commonwealth.

(i) In the case of consolidated returns of net income, the commissioner shall apportion the taxable net income, so far as practicable, in accordance with apportionment rules set forth in this section.

(j) If the apportionment provisions of this section are not reasonably adapted to approximate the net income derived from business carried on within this commonwealth by any type of industry group, the commissioner may, by regulation, adopt alternative apportionment provisions to be applied to such an industry group in lieu of the foregoing provisions.

(k) (1) As used in this section, the following words shall, unless the context otherwise requires, have the following meaning:

"Base period property level", the average value of all the corporation's real and tangible personal property, owned or rented, and used in this commonwealth, as computed under subsection (d), for the corporation's taxable year immediately preceding its first taxable year beginning on or after January first, nineteen hundred and ninety-six, as adjusted to include only real and tangible personal property actively used by the corporation in the conduct of a trade or business on the first day of the immediately succeeding taxable year.

"Base period payroll level", the total amount paid in this commonwealth for compensation, as computed under subsection (e), excluding amounts paid or attributable to the ten most highly compensated officers or employees, for the corporation's taxable year immediately preceding its first taxable year beginning on or after January first, nineteen hundred and ninety-six, as adjusted to include only compensation paid during such taxable year to individuals who are actively employed by the corporation on the first day of the immediately succeeding taxable year.

"Defense corporation", a business corporation which, during the sixty month period ending on December thirty-first, nineteen hundred and ninety-five, has derived more than fifty percent of its total gross receipts from the manufacture of tangible personal property for sale directly or, in the case of a subcontractor, indirectly, to the Department of Defense or any branch of the Armed Forces of the United States.

"Property level", the average value of all the corporation's real and tangible personal property owned or rented and used in this commonwealth for the corporation's taxable year, as computed under subsection (d).

"Payroll level", the total amount paid in this commonwealth for compensation for the corporation's taxable year, as computed under subsection (e), excluding amounts paid or attributable to the ten most highly compensated officers or employees.

(2) For any taxable year beginning on or after January first, nineteen hundred and ninety-six but before January first, two thousand, a defense corporation may, if required to apportion its taxable net income pursuant to subsection (l), elect to have such apportionment determined solely by use of the sales factor. A defense corporation must apportion its income pursuant to said subsection (l) if the denominator of the sales factor is less than ten percent of the taxable net income or it is otherwise determined to be insignificant in producing income. A defense corporation's ability to apportion its taxable net income solely by use of the sales factor shall be reduced to the extent set forth in paragraph (3).

(3) If for any taxable year beginning on or after January first, nineteen hundred and ninety-six but before January first, two thousand, such corporation's property level is less than ninety percent of the base period property level or its payroll level is less than ninety percent of the base period payroll level, the corporation shall instead be required to apportion its taxable net income for such taxable year to the commonwealth in accordance with subsection (l); provided, however, that any reduction in the property level or payroll level for any taxable year that is demonstrated to be attributable to a net reduction in business in this commonwealth under contracts with any branch of the Armed Forces of the United States or with any military or defense agency of a foreign government not resulting from transfers of contract work to facilities of the corporation in other states shall not be taken into account in determining whether the property or payroll level for such taxable year is less than ninety percent of the comparable base period level.

(4) The commissioner of revenue shall promulgate rules and regulations implementing the provisions of this subsection.

(5) For the purpose of determining compliance with the provisions of paragraphs (2), (3) and (4), each defense corporation with more than twenty-five employees, as part of its tax return for each taxable year, shall submit a report, whose form and substance shall be determined by the commissioner of revenue, that describes for each taxable year as of the last day of such taxable year the following: (i) the number, nature and wages of jobs added or lost in the commonwealth and worldwide from the previous taxable year; (ii) the number of contracts with the Armed Forces of the United States or a foreign government for which a bid was (a) submitted, (b) awarded or (c) lost during the taxable year; (iii) the number of contracts with the Armed Forces of the United States or with foreign governments that were terminated during the taxable year; (iv) the nature and amount of any change in the property factor during the taxable year; (v) the nature and amount of any change in the payroll factor in the taxable year; (vi) the dollar amount of revenue foregone by the adoption and utilization of the single sales factor pursuant to this section as compared to the apportionment method in effect for the first taxable year beginning on or after January first, nineteen hundred and ninety-five; (vii) volume of sales in the commonwealth and worldwide; (viii) taxable income in the commonwealth and worldwide; (ix) book value of plant, land and equipment in the commonwealth and worldwide; (x) net capital investments in the commonwealth and worldwide; (xi) net assets; (xii) capacity utilization; and (xiii) debts, itemized by the following categories: (a) loans; and (b) mortgages.

The commissioner of revenue shall annually prepare a comprehensive report utilizing the information received in this paragraph and other sources describing and evaluating the impact, if any, of the utilization of the single sales factor only upon the defense industry. Said report shall contain only cumulative information for all defense corporations submitting reports. Said report shall set forth for all defense corporations submitting reports the cumulative totals worldwide and, where applicable, in the commonwealth of the items specified in clauses (i) to (xiii) and the changes in such aggregate totals from the previous taxable year. The commissioner's report shall be filed not later than October first of each year with the clerk of the senate and the clerk of the house of representatives who shall forward the same to their respective committees on ways and means and to the joint committee on taxation. Said report of the commissioner shall be a public record.

(*l*) (1) As used in this section, the following words shall, unless the context otherwise requires, have the following meaning:

"Manufacturing corporation", a corporation that is engaged in manufacturing. In order to be engaged in manufacturing, the corporation must be engaged, in substantial part, in transforming raw or finished physical materials by hand or machinery, and through human skill and knowledge, into a new product possessing a new name, nature and adapted to a new use. Any operation manufacturing, in substantial part, value-added agricultural products shall be considered a manufacturing corporation.

1. twenty-five percent or more of its gross receipts are derived from the sale of manufactured goods that it manufactures;

2. twenty-five percent or more of its payroll is paid to employees working in its manufacturing operations and fifteen percent or more of its gross receipts are derived from the sale of manufactured goods that it manufactures;

3. twenty-five percent or more of its tangible property is used in its manufacturing operations and fifteen percent or more of its gross receipts are derived from the sale of manufactured goods that it manufactures;

4. thirty-five percent or more of its tangible property is used in its manufacturing operations; or

5. the corporation's manufacturing activities are deemed substantial under relevant regulations promulgated by the commissioner.

In determining whether a process constitutes manufacturing, the commissioner will examine the facts and circumstances of each case.

For the purposes of this section, a corporation which apportions its income pursuant to subsection (k) is not a manufacturing corporation.

"Value-added agricultural products" shall be defined as any products of "farming" or "agriculture", as defined in section 1A of chapter 128, which have increased in market value due to some process other than packaging. Value-added agricultural products shall include, but not be limited to, the following: cheese, butter, buttermilk, yogurt, cream, ice cream, fruit preserves, fruit juices, fruit sauces, fruit syrups, dried fruit, seeded fruits, peeled or chopped fruit and vegetables, processed fruit and vegetables, salads, maple syrup, maple candy, honey and all apicultural products, horticulture nursery and greenhouse products, topiary plants, bacon, sausage, lard, dried or smoked meat, and wool as well as fish, seafood, and other aquatic products.

(2) If a manufacturing corporation, as defined in paragraph (1), has income from business activity which is taxable both within and without this commonwealth, its taxable net income, determined under the provisions of subsection (a), shall not

be apportioned pursuant to the percentage that results from the three-factor formula set forth in subsection (c) but, instead, shall be apportioned by multiplying its taxable net income, determined under the provisions of subsection (a), by the resulting percentage as determined in the following formulas:

(i) For taxable years beginning on or after January first, nineteen hundred and ninety-six but before January first, nineteen hundred and ninety-seven, twenty percent of the property factor plus twenty percent of the payroll factor plus sixty percent of the sales factor.

(ii) For taxable years beginning on or after January first, nineteen hundred and ninety-seven but before January first, nineteen hundred and ninety-eight, fifteen percent of the property factor plus fifteen percent of the payroll factor plus seventy percent of the sales factor.

(iii) For taxable years beginning on or after January first, nineteen hundred and ninety-eight but before January first, nineteen hundred and ninety-nine, ten percent of the property factor plus ten percent of the payroll factor plus eighty percent of the sales factor.

(iv) For taxable years beginning on or after January first, nineteen hundred and ninety-nine but before January first, two thousand, five percent of the property factor plus five percent of the payroll factor plus ninety percent of the sales factor.

(v) For taxable years beginning on or after January first, two thousand, one hundred percent of the sales factor.

(3) Each manufacturing corporation with more than twenty-five employees, apportioning its income in accordance with the provisions of this subsection, as part of its tax return for each year, shall submit a report, whose form and substance shall be determined by the commissioner of revenue, that describes for each taxable year as of the last day of such taxable year the following: (i) the number, nature and wages of jobs added or lost in the commonwealth and worldwide from the previous taxable year; (ii) the nature and amount of any change in the property factor during the taxable year; (iii) the nature and amount of any change in the payroll factor in the taxable year; (iv) the dollar amount of revenue foregone by the increased weighting of the sales factor pursuant to this section as compared to the apportionment method in effect for the first taxable year beginning on or after January first, nineteen hundred and ninety-five; (v) volume of sales in the commonwealth and worldwide; (vi) taxable income in the commonwealth and worldwide; (vii) book value of plant, land and equipment in the commonwealth and worldwide; (viii) net capital investment in the commonwealth and worldwide; (ix) net assets; (x) capacity utilization; and (xi) debts, itemized by the following categories: (a) loans; and (b) mortgages.

The commissioner of revenue shall annually prepare a comprehensive report utilizing the information received in this paragraph and other sources describing and evaluating the impact, if any, of the utilization of the increased weighting of the sales factor upon the manufacturing industry. Said report shall contain only cumulative information for all manufacturing corporations submitting reports. Said report shall set forth for all manufacturing corporations submitting reports the cumulative totals worldwide and, where applicable, in the commonwealth of the items specified in clauses (i) to (xi) and the changes in such aggregate totals from the previous taxable year. The commissioner's report shall be filed not later than October first of each year with the clerk of the senate and the clerk of the house of representatives who shall forward the same to their respective committees on ways and means and to the joint committee on taxation. Said report of the commissioner shall be a public record subject to the provisions of section ten of chapter sixty-six.

(m) (1) As used in this subsection and in subsections (c) and (f), the following words shall, unless the context otherwise requires, have the following meaning:

"Administration services", include, but are not limited to, clerical, fund or shareholder accounting, participant record keeping, transfer agency, bookkeeping, data processing, custodial, internal auditing, legal and tax services performed for a regulated investment company, but only if the provider of such service or services during the taxable year in which such service or services are provided also provides or is affiliated with a person that provides management or distribution services to any regulated investment company.

"Affiliate", the meaning as set forth in 15 USC section a-2(a)(3)(C), [1] as may be amended from time to time.

"Base period employment level", the number of qualified employees in this commonwealth of a mutual fund service corporation as of January first, nineteen hundred and ninety-six, or if the mutual fund service corporation is one of the mutual fund service corporations filing a combined return for the tax year ending as of December thirty-first, nineteen hundred and ninety-six, the aggregate number of all qualified employees as of January first, nineteen hundred and ninety-six of all of the mutual fund service corporations participating in such combined return. If a mutual fund service corporation was not engaged in business in the commonwealth on January first, nineteen hundred and ninety-six, the base period employment level shall be the average employment level for the first two taxable years during which it is engaged in business in the commonwealth. In the event of the acquisition of a business or line of business or any other corporate restructuring that increases the number of qualified employees of the mutual fund service corporation, the base period employment level to be applied in the taxable year in which the acquisition or restructuring occurs and in all subsequent taxable years shall be increased to reflect such an increase. In the event of a divestiture of a line of business or other corporate restructuring that decreases the number of qualified employees of the mutual fund service corporation, the base period employment level to be applied in the taxable year in which such divestiture or other corporate restructuring occurs and in all subsequent taxable years shall be recalculated to reflect such decrease only if the mutual fund service corporation can demonstrate that such divestiture or other corporate restructuring will not result in any reduction in the number of jobs in the commonwealth.

"Distribution services", include, but are not limited to, the services of advertising, servicing, marketing or selling shares of a regulated investment company, but, in the case of advertising, servicing or marketing shares, only where such service is performed by a person who is, or in the case of a close end company, was, either engaged in the services of selling regulated investment company shares or affiliated with a person that is engaged in the service of selling regulated investment company shares. In the case of an open end company, such service of selling shares must be performed pursuant to a contract entered into pursuant to 15 USC section a-15(b), [2] as from time to time amended.

"Domicile", presumptively the shareholder's mailing address on the records of the regulated investment company. If, however, the regulated investment company or the mutual fund service corporation has actual knowledge that the shareholder's primary residence or principal place of business is different than the shareholder's mailing address said presumption shall not control. If the shareholder of record is a company which holds the shares of the regulated investment company as depositor for the benefit of a separate account, then the shareholder shall be the contract owners or policyholders of the contracts or policies supported by the separate account, and it shall be presumed that the domicile of said shareholder is the contract owner's or policyholder's mailing address to the extent that the company maintains such mailing addresses in the regular course of business. If the regulated investment company or the mutual fund service corporation has actual knowledge that the shareholder's principal place of business is different than the shareholder's mailing address said presumption shall not control.

"Employment level", the number of qualified employees of the mutual fund service corporation in the taxable year, or if the mutual fund service corporation is one of the mutual fund service corporations filing a combined return for such taxable year, the sum of the number of qualified employees of all such mutual fund service corporations in this commonwealth for the taxable year.

"Jobs commitment level", except as provided in subparagraph (b) of paragraph (4), for taxable years beginning on or after January first, nineteen hundred and ninety-seven, but before January first, nineteen hundred and ninety-eight, an employment level of one hundred and five percent of the base period employment level; for taxable years beginning on or after January first, nineteen hundred and ninety-eight, but before January first, nineteen hundred and ninety-nine, an employment level of one hundred and ten percent of the base period employment level; for taxable years beginning on or after January first, nineteen hundred and ninety-nine, but before January first, two thousand, an employment level of one hundred and fifteen percent of the base period employment level; for taxable years beginning on or after January first, two thousand, but before January first, two thousand and one, an employment level of one hundred and twenty percent of the base period employment level; for taxable years beginning on or after January first, two thousand and one, but before January first, two thousand and two, an employment level of one hundred and twenty-five percent of the base period employment level; for taxable years beginning on or after January first, two thousand and two, but before January first, two thousand and three, an employment level of one hundred and twenty-five percent of the base period employment level. If a mutual fund service corporation was not engaged in business in the commonwealth on January first, nineteen hundred and ninety-six, for all taxable years beginning before January first, two thousand and three, the jobs commitment level shall be the base period employment level increased by five percent of the base period employment level for every year after which the base period employment level is established.

"Management services", include, but are not necessarily limited to, the rendering of investment advice directly or indirectly to a regulated investment company, making determinations as to when sales and purchases of securities are to be made on behalf of the regulated investment company, or the selling or purchasing of securities constituting assets of a regulated investment company, and related activities, but only where such activity or activities are performed: (i) pursuant to a contract with the regulated investment company entered into pursuant to 15 USC section a-15(a),[3] as from time to time amended; (ii) for a person that has entered into such contract with the regulated investment company; or (iii) for a person that is affiliated with a person that has entered into such contract with a regulated investment company.

"Mutual fund sales", taxable net income derived within the taxable year directly or indirectly from the rendering of management, distribution or administration services to a regulated investment company, including net income received directly or indirectly from trustees, sponsors and participants of employee benefit plans which have accounts in a regulated investment company.

"Mutual fund service corporation", any corporation doing business in the commonwealth which derives more than fifty percent of its gross income from the provision directly or indirectly of management, distribution or administration services to or on behalf of a regulated investment company and from trustees, sponsors and participants of employee benefit plans which have accounts in a regulated investment company.

"Number of qualified employees", the number of qualified employees who are employed by a mutual fund service corporation in the commonwealth as of the last day of a given taxable year.

"Number of qualified employees worldwide", the total number of qualified employees worldwide who were employed by the mutual fund service corporation on a specified date.

"Qualified employee in this commonwealth", an individual who: (i) is employed by a mutual fund service corporation; (ii) works on a full-time basis with a normal work week of thirty or more hours; (iii) at the inception of the employment relationship does not have a termination date which is either a date certain or determined with reference to the completion of some specified scope of work; (iv) is eligible to receive employee benefits including, but not limited to, paid holidays, vacation and unemployment benefits; and (v) is subject to Massachusetts income tax withholding. Three or fewer individuals who collectively fulfill the requirement of clause (ii) and who each meet the requirements of clauses (i), (iii), (iv) and (v) shall be counted as one qualified employee for purposes of this section.

"Qualified employee worldwide", an individual who meets the criteria in subsections (i) to (iv), inclusive, of the definition of "Qualified employee in this commonwealth." Three or fewer individuals who collectively fulfill the requirement of clause (ii) of said definition of "Qualified employee in this commonwealth" and who each meet the requirements of clauses (i), (iii) and (iv) of said definition of "Qualified employee in this commonwealth" shall be counted as one qualified employee for purposes of this section.

"Regulated investment company", the meaning as set forth in section 851 of the Internal Revenue Code as amended and in effect for the taxable year.

(2) Notwithstanding any other provision of the General Laws, any mutual fund service corporation having income from mutual fund sales to one or more regulated investment companies with shareholders domiciled within and without this commonwealth shall apportion such income pursuant to the provisions of subsection (c). Furthermore, any such mutual fund service corporation whose employment level in the current taxable year is equal to or greater than its jobs commitment level for such taxable year and who satisfies the requirements of paragraphs (3) and (4), or any such mutual fund service corporation for which the jobs commitment level requirement no longer applies shall apportion such income by multiplying it by one hundred percent of the sales factor, subject to the provisions of clause (i). The provisions of paragraph (2) of subsection (m) shall take effect as of July first, nineteen hundred and ninety-seven. For taxable years beginning on or after January first, nineteen hundred and ninety-seven and including July first, nineteen hundred and ninety-seven, a mutual fund service corporation shall apportion its taxable income to this commonwealth for such taxable year by multiplying taxable net income by the percentage calculated by weighting the apportionment percentage determined under subsection (c), as in effect before July first, nineteen hundred and ninety-seven, by the number of days in such taxable year preceding July first, nineteen hundred and ninety-seven and by weighting the apportionment percentage determined under said paragraph (2) of said subsection (m) by the number of days in such taxable year on and after July first, nineteen hundred and ninety-seven.

(3) Notwithstanding a mutual fund service corporation's failure to achieve its jobs commitment level in the taxable year, the percentage set forth in the second paragraph of paragraph (2) of subsection (m) may be applied, where the failure to achieve the jobs commitment level for any taxable year is demonstrated by the mutual fund service corporation to be a direct result of adverse economic conditions in that taxable year.

(a) Adverse economic conditions can affect only one taxable year except as set forth in subparagraph (b) and (c). Adverse economic conditions shall exist only where during any twelve month period ending during the taxable year, either: (A) the Standard & Poor's 500 Stock Index decreases ten percent or more compared to its level at the beginning of such twelve month period or (B) the average daily trading volume on the New York Stock Exchange decreases fifteen percent or more compared to the average over the preceding twelve months; or (C) at any time during the taxable year, the total assets under management of the mutual funds served by the mutual fund service corporation decreases twelve and one-half percent or more compared to such total assets under management twelve months earlier.

(b) If a mutual fund service corporation demonstrates that failure to achieve the jobs commitment level for one taxable year was the direct result of an adverse economic condition, such corporation may decrease its jobs commitment level by five percent of the base period employment level for all subsequent taxable years prior to the first taxable year beginning on or after January first, two thousand and two.

(c) If a mutual fund service corporation demonstrates that failure to achieve the jobs commitment level for more than one taxable year was the direct result of an adverse economic condition, such corporation may decrease its jobs commitment level by five percent of the base period employment level for each taxable year in which an adverse economic condition was established for all subsequent taxable years prior to the first taxable year beginning on or after January one, two thousand and two. However,

for each taxable year beginning on or after January first, two thousand and two, but prior to the first taxable year beginning on or after January first, two thousand and four, the jobs commitment level shall be an employment level equal to the sum of: (i) the jobs commitment level for the most recent taxable year immediately prior to such year for which an adverse economic condition was not established; and (ii) five percent of the base period employment level.

(4) For the purposes of determining compliance with the provisions of this subsection, each mutual fund service corporation that seeks to rely on the provisions of this subsection for the taxable year in question shall submit, as part of its tax return, a report, with such supporting documentation as the commissioner may require, containing the following:

(i) the number, nature, and aggregate wages of the qualified employees in this commonwealth and qualified employees worldwide as of the end of the taxable year and the number of jobs added or lost as compared to the previous taxable year;

(ii) the number of the qualified employees in this commonwealth as of the last day of the taxable year sorted by place of employment;

(iii) the base period employment level;

(iv) the volume of sales attributable to this commonwealth and worldwide;

(v) the taxable income in this commonwealth;

(vi) net assets under management in this commonwealth and worldwide; and

(vii) the median income of all of qualified employees in the commonwealth and of all of its qualified employees worldwide.

The information provided by each individual mutual fund service corporation shall be treated as confidential under the provisions of section twenty-one of chapter sixty-two C. Said information shall be used by the commissioner of revenue to prepare a comprehensive annual report setting forth the changes in the aggregate from the previous taxable year for each of the items listed above. The commissioner's report shall also set forth any recommendations the commissioner may have for any amendments to the provisions of this section, and the reasons for any such recommendations. The commissioner's report shall be filed by October first of each year with the clerk of the senate and the clerk of the house of representatives who shall forward the same to the respective committees on ways and means and the joint committee on taxation.

(5) The commissioner of revenue shall promulgate regulations implementing the provisions of this subsection.

(n) In any case in which a purchasing corporation makes an election under section 338 of the Code, the target corporation shall be treated as having sold its assets for purposes of this section.

Credits

Amended by St.1933, c. 342, § 3; St.1960, c. 553; St.1961, c. 419, § 1; St.1966, c. 698, § 58; St.1970, c. 562; St.1971, c. 555, § 33; St.1972, c. 748, § 1; St.1973, c. 752, §§ 4 to 7; St.1974, c. 722, §§ 1, 2; St.1975, c. 684, §§ 49, 50; St.1978, c. 530, §

1; St.1982, c. 658, §§ 4, 5; St.1983, c. 233, § 44; St.1988, c. 202, § 17; St.1995, c. 280, §§ 1, 2; St.1996, c. 151, §§ 208, 209; St.1996, c. 264, §§ 2 to 4; St.2004, c. 262, §§ 41 to 43, eff. Aug. 9, 2004; St.2005, c. 163, § 26, eff. Dec. 8, 2005; St.2006, c. 123, §§ 60, 61, eff. June 24, 2006; St.2008, c. 130, § 24, eff. Jan. 1. 2009; St.2008, c. 173, §§ 56 to 62, eff. July 3. 2008; St.2011, c. 194, § 31, eff. Nov. 22, 2011; St.2013, c. 46, §§ 36, 37, eff. Jan. 1, 2014.

Notes of Decisions (173)

Footnotes

1 So in original; probably should read "15 USC section 80a-2(a)(3)(C)".

2 So in original; probably should read "15 USC section 80a-15(b)".

3 So in original; probably should read "15 USC section 80a-15(a)".

M.G.L.A. 63 § 38, MA ST 63 § 38

Current through Chapter 33 of the 2015 1st Annual Session

End of Document

Massachusetts General Laws Annotated
Part I. Administration of the Government (Ch. 1-182)
Title IX. Taxation (Ch. 58-65c)
Chapter 63. Taxation of Corporations (Refs & Annos)

M.G.L.A. 63 § 38M

§ 38M. Credit against amount of excise due; research expenses

Effective: October 31, 2014
Currentness

<[Text of section applicable for tax years beginning on or after January 1, 2015. See 2014, 287, Sec. 123.]>

(a)(1) A business corporation shall be allowed a credit against its excise due under this chapter equal to the sum of 10 per cent of the excess, if any, of the qualified research expenses for the taxable year over the base amount and 15 per cent of the basic research payments determined under subsection (e)(1)(A) of section 41 of the federal Internal Revenue Code.

(2) Other than as provided in paragraph (3), "qualified research expenses", "basic research payment", "credit year" and any other term affecting the calculation of the credit shall, unless the context otherwise requires, have the same meanings as under said section 41 of said Code as amended and in effect on August 12, 1991; provided, however, that the terms shall only apply to expenditures for research conducted in the commonwealth.

(2) [1] For the purposes of this subsection, the "base amount" shall be the product of: (i) the average annual gross receipts of the taxpayer for the 4 taxable years preceding the credit year; and (ii) a fixed-base ratio and the "fixed base ratio" shall be the percentage which the average aggregate qualified research expenses for the taxpayer for the third and fourth taxable years preceding the credit year is of the annual average gross receipts for those years; provided, however, that the fixed base ratio shall not exceed 16 per cent.

In determining the amount of the credit allowable under this section, the commissioner of revenue may aggregate the activities of all corporations that are members of a controlled group of corporations as defined by subsection (f)(1)(A) of said section 41 of said Code. The commissioner also may aggregate the activities of all entities, whether or not incorporated, that are under common control as defined by subsection (f)(1)(B) of said section 41 of said Code.

(b) A business corporation may choose to have the credit determined under this subsection rather than under subsection (a). At the election of the taxpayer for calendar years 2015, 2016 and 2017, the amount of the taxpayer's credit shall be equal to 5 per cent of the taxpayer's qualified research expenses for the taxable year that exceeds 50 per cent of the taxpayer's average qualified research expenses for the 3 taxable years preceding the taxable year for which the credit is being determined. At the election of the taxpayer for calendar years 2018, 2019 and 2020, the amount of the taxpayer's credit shall be equal to 7.5 per cent of the taxpayer's qualified research expenses for the taxable year that exceeds 50 per cent of the taxpayer's average qualified research expenses for the 3 taxable years preceding the taxable year for which the credit is being determined. Beginning in calendar year 2021, at the election of the taxpayer, the amount of the taxpayer's credit shall be equal to 10 per cent of the taxpayer's qualified research expenses for the taxable year that exceeds 50 per cent of the taxpayer's average qualified research expenses for the 3 taxable years preceding the taxable year for which the credit is being determined. If the taxpayer did not have qualified research expenses in any 1 of the 3 taxable years preceding the taxable year for which the credit is being determined, the amount of the credit is equal to 5 per cent of the taxpayer's qualified research expense for the taxable year. Under this subsection, "qualified

research expenses" and any other terms affecting the calculation of the credit shall, unless the context otherwise requires, have the same meanings as under said section 41 of said Code as amended and in effect on January 1, 2014; provided, however, that the terms shall only apply to expenditures for research conducted in the commonwealth.

(c) For the purposes of section 30, the deduction from gross income that may be taken with respect to any expenditures qualifying for a credit under said section 41 of said Code as amended and in effect on August 12, 1991 shall be based upon its cost less the credit allowable under this section; provided, however, that subsection (c) of section 280C of said Code shall not apply.

(d) The credit allowed under this section for any taxable year shall not reduce the excise to less than the amount due under subsection (b) of section 39, section 67 and under any act in addition thereto.

(e) The credit allowed under this section shall be limited to 100 per cent of a corporation's first $25,000 of excise, as determined before the allowance of any credits, plus 75 per cent of the corporation's excise, as so determined in excess of $25,000. The commissioner shall promulgate regulations similar to those authorized under subsection (c)(2)(B) of section 38 of said Code for the purposes of apportioning the $25,000 amount among members of a controlled group. Nothing in this section shall alter section 32C as it affects other credits under this chapter.

(f) For a corporation filing a combined return of income under section 32B, a credit generated by an individual member corporation under this section shall first be applied against the excise attributable to the corporation under section 39 subject to the limitations of subsections (d) and (e). An member corporation with an excess research and development credit may apply its excess credit against the excise of another group member to the extent that the other member corporation may use additional credits under the limitations of said subsections (d) and (e). Unused and unexpired credits generated by a member corporation shall be carried over from year to year by the individual corporation that generated the credit. Nothing in this section shall alter paragraph (h) of section 31A.

(g) Any corporation entitled to a credit under this section for any taxable year may carry over and apply to its excise for any 1 or more of the next succeeding 15 taxable years the portion, as reduced from year to year, of its credit which exceeds its excise for the taxable year. Any corporation may carry over and apply to its excise for any subsequent taxable year the portion of those credits, as reduced from year to year, which were not allowed by subsection (e).

(h) The commissioner shall promulgate regulations as necessary to implement this section.

(i) This section shall apply to expenditures incurred on or after January 1, 1991; provided, however, that, in the case of any taxable year which begins before January 1, 1991 and ends before December 31, 1991, the base amount and the qualified organization base period amount with respect to the taxable year shall be the amount that bears the same ratio to the base amount and the qualified organization base period amount for the year, determined without regard to this paragraph, as the number of days in the taxable year on or after January 1, 1991 bears to the total number of days in that taxable year.

(j)(1) The credit allowed by this section, at the election of the taxpayer in accordance with regulations promulgated by the commissioner, may be applied separately with respect to the: (i) qualified research expenses and gross receipts of the taxpayer attributable to defense-related activities; and (ii) qualified research expenses and gross receipts of the taxpayer attributable to other activities.

(2) For the purposes of this subsection, "defense-related activities" shall mean any activity carried out in the commonwealth that relates to the business of researching, developing and producing for sale, pursuant to a contract or subcontract thereof: (i) any arm, ammunition or implement of war designated in the munitions list published pursuant to section 38 of the federal Arms Export Act, 22 U.S.C. § 2778 to the extent that the property shall be specifically designed, modified or equipped for military purposes; and (ii) equipment for the federal National Aeronautics and Space Administration.

(3) This paragraph shall apply to taxable years beginning on or after January 1, 1995.

(k)(1) As used in this section, the following words shall have the following meanings unless the context clearly requires otherwise:

"Life sciences", advanced and applied sciences that expand the understanding of human physiology and may lead to medical advances or therapeutic applications including, but not limited to, agricultural biotechnology, biogenerics, bioinformatics, biomedical engineering, biopharmaceuticals, biotechnology, chemical synthesis, chemistry technology, diagnostics, genomics, image analysis, marine biology, marine technology, medical devices, nanotechnology, natural product pharmaceuticals, proteomics, regenerative medicine, RNA interference, stem cell research and veterinary science.

"Person", a natural person, corporation, association, partnership or other legal entity.

"Taxpayer", a certified life sciences company or person subject to the taxes imposed by chapters 62, 63, 64H or 64I.

(2) If a credit claimed under this section by a taxpayer exceeds the amount that may otherwise be allowed under this section for a taxable year, 90 per cent of the balance of that credit may, at the option of the taxpayer and to the extent authorized pursuant to the life sciences tax incentive program established in subsection (d) of section 5 of chapter 23I, be refundable to the taxpayer for the taxable year. If the credit balance is refunded to the taxpayer, the credit carryover provisions of paragraph (f) shall not apply.

Credits

Added by St.1991, c. 138, § 130. Amended by St.1991, c. 176, § 6; St.1995, c. 280, § 3; ; St.2008, c. 130, § 28, eff. Jan. 1, 2009; St.2008, c. 173, §§ 76 to 78, eff. July 3, 2008; St.2014, c. 287, § 54, eff. Aug. 13, 2014; St.2014, c. 359, § 20, eff. Oct. 31, 2014.

Footnotes

1 So in enrolled bill; should probably be paragraph (3) of subsection (a).

M.G.L.A. 63 § 38M, MA ST 63 § 38M

Current through Chapter 33 of the 2015 1st Annual Session

End of Document

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State Tax Today

DECEMBER 18, 1995

Full Text: 'Radical Apportionment Reform Comes To Massachusetts.'

Summary by taxanalysts

The full text is available of a special report, "Radical Apportionment Reform Comes to Massachusetts," by Joseph X. Donovan, which appeared in the December 18, 1995, issue of State Tax Notes.

====== SUMMARY ======

[Joseph X. Donovan is director of Coopers & Lybrand's Multistate Tax Services Group, Boston. He is a member of State Tax Notes' Advisory Board.

For news coverage of adoption of the legislation, see State Tax Notes, Dec. 4, 1995, p. 1589. For the full text of the bill, H 5617 (now Chapter 280 of the Acts of 1995), see 95 STN 229-18.]

====== FULL TEXT ======

Of the 47 states that impose a corporate income tax, 44 use some variation of the rules set forth in the Uniform Division of Income for Tax Purposes Act (UDITPA), a model apportionment regime first promulgated in 1957 by the National Conference of Commissioners on Uniform State Laws, to carve up the income pie among the states. Under this regime, the portion of a corporation's income that is deemed to have been earned in a state is determined by applying to "everywhere" income an average of three fractions -- the corporation's in-state property divided by its everywhere property, its in-state payroll divided by its everywhere payroll, and its in- state sales divided by its everywhere sales. This approach is commonly referred to as "the Massachusetts formula," because the drafters of UDITPA looked to the existing Massachusetts apportionment rules as a model. In point of fact, Massachusetts already departs from UDITPA

by assigning a double weight to sales in its apportionment formula. The Massachusetts apportionment factor therefore equals the payroll factor plus the property factor plus two times the sales factor, divided by four.

As of 1996, Massachusetts will begin to move away substantially from the formula that bears its name. Under legislation advanced by Raytheon Co. and strongly supported by Gov. William Weld (R), Associated Industries of Massachusetts, and the Massachusetts Society of CPAs, among others, the commonwealth will immediately adopt a formula under which defense companies may apportion their income solely on the basis of sales; it will phase in a "single-sales- factor" approach for most manufacturers over a five-year period.

The shift from the UDITPA rules to a single-sales-factor approach is intended to spur investment in Massachusetts. To see how this economic incentive is expected to work, take the case, for example, of a Massachusetts-based corporation that is engaged in manufacturing, has income of $100 million, and has 70 percent, 65 percent, and 30 percent of its property, payroll and sales, respectively, in Massachusetts. Under current law, the corporation pays tax to Massachusetts on 48.75 percent of its income, that is, 70 percent plus 65 percent plus 30 percent plus 30 percent, all divided by four. At the 9.5 percent rate, the Massachusetts tax on income is $4.63 million.

Once the single-factor regime is fully phased in, this corporation on the same facts will pay tax to Massachusetts on 30 percent of its income, or $30 million. At the 9.5 percent rate, the tax will be reduced to $2.85 million.

Furthermore, under the single-factor approach, this corporation will be able to invest in people and property in the commonwealth without raising its Massachusetts factor or its Massachusetts tax liability. The addition of Massachusetts people and property will likely lower the overall state tax burden of the company, because the states applying the standard UDITPA approach will allow the company to reduce its property and payroll factors in light of the addition of property and payroll in Massachusetts, with no proportional increase in property and payroll in those states. If, for example, the corporation described above now has $100 million of payroll, $65 million of which is paid to Massachusetts employees, and it adds $55 million of payroll paid to new Massachusetts employees, leaving all other factors constant, its Massachusetts tax liability under a single-sales-factor approach will remain the same, but its total factors in other states, assuming the application of UDITPA rules in those states, will be reduced from 45 percent to 40.86 percent. If those states impose tax at the same 9.5 percent rate as Massachusetts, the annual tax burden of the company will be reduced in those states by about $395,000 as a consequence of adding to the Massachusetts payroll base. In effect, the new rules produce an incentive to invest in the state, the cost of which is borne in part by the states that compete with Massachusetts for business.

Of course, many non-Massachusetts companies subject to these new rules will find their Massachusetts tax increased if the distribution of their operations is not changed. For example, a corporation with $100 million of income and 5 percent, 3 percent, and 20 percent of its property, payroll, and sales, respectively, in Massachusetts, will see its Massachusetts tax increased from $ 1.14 million to $1.9 million, with no offsetting decrease in the other states where it does business.

Whether, in fact, corporations will respond to the change in the law by adding to or retaining Massachusetts jobs has been the subject of some debate. Professor Peter Enrich of Northeastern University testified against adoption of the single-sales-factor approach before the Joint Taxation Committee of the legislature, relying largely on the argument that corporations do not take state tax incentives into account in deciding where to place or to grow businesses. Raytheon, on the other hand, placed reliance on a DRI/McGraw Hill study suggesting a correlation between tax incentives and job growth. The author's own firm conducts an annual survey of tax executives that recently reported, based on 1994 survey results, that state incentive programs were a major driver of business siting decisions (see State and Local Taxes: The Burden Grows, Coopers & Lybrand 1995).

The Defense Contractor Provisions

The new law allows defense companies an election to use a single sales factor for taxable years beginning on or after January 1, 1996, but before January 1, 2000. Defense companies are defined as those deriving more than 50 percent of their receipts during a 60-month period ending with calendar year 1995 from manufacture of tangible personal property for sale to the Department of Defense or to the armed forces of the United States. Companies that do not manufacture munitions or other goods for the American military, including service companies heavily dependent on military sales and companies that sell most of their goods directly to the armed forces of foreign governments, presumably will not qualify.

In the debate over the bill, House Speaker Charles Flaherty (D) and others pushed hard for a "clawback" provision of some kind to ensure that the taxpayers who benefited from the bill would indeed respond to it by maintaining or growing their Massachusetts payroll. Some suggested that the bill should require such taxpayers to pay back to the commonwealth the tax benefits attributable to the legislation if they later cut Massachusetts employment. Rather than requiring such a dollar-for-dollar payback, the law as enacted provides that if a company's Massachusetts payroll or property drops below 90 percent of its Massachusetts payroll or property for a "base period," the company will not be entitled to elect the special defense company apportionment method. (It will, however, nevertheless be entitled to use the phased-in single-sales-factor approach that applies to other manufacturers and is described below.)

"Base-period payroll" is defined as Massachusetts compensation, excluding amounts paid or attributable to the 10 most highly compensated officers or employees in the company, for the taxable year immediately preceding the first taxable year beginning on or after January 1, 1996, but adjusted to include only compensation paid during such taxable year to individuals actively employed by the corporation on the first day of the immediately succeeding taxable year. For a calendar year taxpayer, the base period will be 1995, but only the compensation of personnel actively employed on January 1, 1996, will be counted.

Likewise, "base-period property" for a calendar year taxpayer is the value of 1995 Massachusetts property, adjusted to include only property actively used by the corporation in the conduct of its business on January 1, 1996.

In determining whether the clawback provisions apply, a reduction in Massachusetts business that is attributable to contracts with any branch of the armed forces of the United States or any

military or defense agency of a foreign government is not taken into account unless it results from transfers of contract work to facilities of the corporation in other states. Accordingly, if a defense contractor cuts back on Massachusetts employment because, for example, a particular Defense Department procurement program shrinks, but does not move jobs to another state, the reduction in Massachusetts work force will not preclude use of the single-factor formula.

Provisions for Manufacturers

In general. For manufacturers, the bill phases in a single- sales-factor approach on a mandatory basis over a five-year period as follows:

Years Beginning	Sales, Property, and Payroll Weighting
January 1, 1996	60%, 20%, 20%
January 1, 1997	70%, 15%, 15%
January 1, 1998	80%, 10%, 10%
January 1, 1999	90%, 5%, 5%
January 1, 2000	100%

The definition of a "manufacturing corporation" that is subject to these rules borrows heavily from the criteria that are used in Massachusetts to determine whether a corporation is a manufacturer for purposes of three other tax benefits -- exemption of machinery from local property taxation, eligibility for the 3 percent investment tax credit, and eligibility for exemption from sales tax for research and development (R&D) equipment and supplies. The principal difference for single-sales-factor purposes is that the criteria will be applied to the activities of a corporation everywhere, not just in Massachusetts. This approach was necessary to prevent manufacturers in the aggregate from having the best of both worlds. If "manufacturer" were defined solely on the basis of Massachusetts activities, in-state companies, which tend to benefit from the single-factor approach, would be subject to it, whereas out- of-state manufacturers, for whom it usually represents a tax increase, would not.

The law defines "manufacturing corporation" as "a domestic or foreign corporation that is engaged in manufacturing," and specifies that the corporation "must be engaged, in substantial part, in transforming raw or finished physical materials by hand or machinery, and through human skill and knowledge, into a new product possessing a new name, nature and adapted [sic] to a new use." The law states explicitly that the Department of Revenue (DOR) must examine the facts and circumstances of each case in determining whether a particular process constitutes manufacturing.

The manufacturing activities of a corporation will be considered substantial if any one of the following criteria is met:

o 25 percent or more of its gross receipts are derived from the sale of manufactured goods that it manufactures;

o 25 percent or more of its payroll is paid to employees working in its manufacturing operations and 15 percent

or more of its gross receipts are derived from manufacturing;

o 25 percent or more of its tangible property is used in its manufacturing operations and 15 percent or more of its gross receipts are derived from manufacturing;

o 35 percent or more of its tangible property is used in its manufacturing operations; or

o the corporation's manufacturing activities are deemed substantial under regulations promulgated by the commissioner of revenue.

In light of the history of manufacturing status in Massachusetts, corporations considering the impact of these rules on their operations should bear two things in mind. First, the DOR has issued a regulation on manufacturing status for local property tax and other purposes (830 CMR 58.2.1) that will undoubtedly serve as a guide to how the new rules will be interpreted (except that, as is noted above, the test for local property tax purposes is applied only to Massachusetts activities). Second, the criteria in both the manufacturing regulation and the new statute have their origin in a long line of cases in which the Supreme Judicial Court and the Appellate Tax Board have opined on what constitutes a manufacturer. The results in these cases can be reconciled only by tortured logic, because the courts seem to have been strongly influenced by the legislative policy behind manufacturing status -- encouragement of Massachusetts manufacturing activities -- but less concerned about articulating a standard that can be used to cut through any given set of facts.

Among the myriad issues with which both Massachusetts and non- Massachusetts manufacturers will have to grapple are the following:

o The courts have sometimes concluded that the key to qualification is whether there is a significant difference between what comes in the door and what goes out, such that a person is inclined to call the product by a different name. While, for example, Papa Gino's was granted manufacturing status on the theory that the tomato paste, cheese, and dough it bought were different from the pizzas it sold, a discount steakhouse chain was unsuccessful in arguing that it was a manufacturer because the meat it sold had to be subjected to various "industrial" processes to make it palatable. (Compare Papa Gino's of America, Inc. v. State Tax Commission, ATB Docket No. 93091, CCH MA Tax Rep. par. 200-530, April 25, 1979, and York Steak Systems Inc. v. Commissioner of Revenue, ATB Docket No. 124678, CCH MA Tax Rep. par. 201-001, December 21, 1983). In light of this test, the DOR has often drawn a distinction between manufacturing and mere assembly, and denied

manufacturing status to companies that buy products nearly complete and merely configure them for sale.

o In the case law, a concept has developed that is not theoretically consistent with the requirement that a corporation itself change the essential nature of what it buys. The Supreme Judicial Court has said that, in circumstances that it refuses to define in advance, it will sometimes grant manufacturing status to companies that do not make changes themselves that radically alter the materials they take in, but rather perform an activity that is essential to manufacturing and forms an integral part of a chain of processes performed by more than one legal entity that, taken together, amount to manufacturing. This theory has been applied, for example, to wool scouring (see Assessors of Boston v. Commissioner of Corporations and Taxation, 323 Mass. 730 (1949)) and to the processing of scrap steel (see William F. Sullivan & Co. v. Commissioner of Revenue, 413 Mass. 576 (1992)).

o The DOR has also taken the position that "outsourced" manufacturing activities are not counted toward qualification. This issue has arisen most notably in the context of producers of computer software. While the DOR has conceded that the production of off-the-shelf software constitutes manufacturing in general (consistent with its view that sales of such software are sales of tangible personal property for sales and use tax purposes), it has declined to grant manufacturing status to companies that outsource the duplication of programs onto floppy disks.

o The DOR has taken a rather narrow view of both the people and property deemed to be engaged in manufacturing. Under its regulation, assembly-line employees and their direct supervisors of course get counted, but the wages of personnel who are engaged in administrative activities do not, even if their activities support the manufacturing process. The author is also aware of at least one case in which the DOR is taking the position on audit that floor space devoted to interim storage of semi-processed materials is not considered to be used in manufacturing, even though interim storage is considered to be manufacturing for Massachusetts sales and use tax purposes.

o The eligibility of "start-up" companies for manufacturing status has been controversial. At one point the DOR generally took the position that a corporation could not qualify for manufacturing status if it had not yet made any sales of manufactured property. This view was considered by many to defeat the policy behind the classification. A task force on the business climate in Massachusetts for the biotechnology industry created by the Governor's Council on Economic Growth and Technology recommended in 1991 that this position be reconsidered, and the DOR revised its manufacturing regulation to add a new criterion for qualification -- a corporation would qualify regardless of other circumstances if 35 percent or more of its property were devoted to manufacturing. Implicitly, given the impetus for the change, the regulation seemed to count assembly-line equipment and floor space as devoted to manufacturing even if a corporation had not yet sold anything that it manufactured. DOR personnel charged with interpreting the revised regulation have not always agreed, however, that the change, intended to cure the problem for start-ups, does so in fact.

Documenting status: the burden of proof. For local property tax purposes, corporations that wish to be qualified as manufacturers submit a special form to the DOR -- Form 355Q -- that lays out both qualitative and quantitative information derived from the manufacturing regulation so that the DOR can make a tentative decision whether the corporation qualifies. Ordinarily, the DOR follows up with a site visit to get a better sense of the activities being conducted by the corporation. The process of gathering the information to support the classification can be onerous, even though it is limited to Massachusetts activities. Under the single-sales- factor rules, the same analysis will have to be made on a nationwide level. This will place a very heavy burden on both corporations and the DOR auditors.

The DOR has a history of using the general principle that taxpayers bear the burden of proof to support technical results that may be dubious. (For example, its apportionment regulations arbitrarily define "documentary evidence" that will be given weight in an audit so as not to include any affidavits prepared in the course of the audit, even though such evidence would be considered probative in any court of law; see Reg. 830 CMR 63.38.1(2)). In the context of the single-sales-factor legislation, it will be interesting to see how the DOR addresses the burden of proof, in light of the fact that in-state companies will very much want to be classified as manufacturers, whereas out-of-state companies generally will not. (Exceptions here are (1) out-of-state companies that have losses they wish to apply against the income of affiliates; and (2) companies that find a greater advantage in the benefits of Massachusetts manufacturing status for local property tax and other purposes). It is quite likely that out-of-state companies in particular that do some manufacturing will be hard-pressed to compile the companywide information necessary to convince the DOR that they are not manufacturers for single-sales-

factor purposes.

Treatment of Controlled Groups

Nothing in the single-sales-factor legislation authorizes the DOR to apply the tests for single-sales-factor treatment otherwise than on a separate-legal-entity basis. This is in contrast to the Massachusetts R&E credit rules, for example, which expressly call for calculating the credit by aggregating the activities of a controlled group (see General Laws Chapter 63, section 38M (a)). It therefore appears that a company that has significant defense activities but does not meet the 50 percent gross receipts test, for example, may be able to split out its defense activities into a separate corporation and qualify with respect to that corporation. Arguably, this is consistent with the legislative policy underlying the new law to limit the single-sales-factor approach in early years to defense businesses, because segregation of the business in a separate corporation will only benefit the defense piece of the business.

New Reporting Requirements

In the debate over the single-sales-factor legislation, skepticism was expressed in some quarters as to whether it would accomplish its intended result. The law includes new reporting requirements designed to allow the DOR to compile a database demonstrating the effect of the law on job creation and its revenue impact. The DOR's report will not include any company-specific information.

Under the law, any defense corporation or manufacturing corporation with more than 25 employees must report with its annual tax return the following:

o the number, nature, and wages of jobs added or lost in Massachusetts and worldwide from the previous taxable year;

o the nature and amount of any change in the property factor and the payroll factor in the taxable year;

o the dollar amount of revenue forgone by the increased weighting of the sales factor as compared to the apportionment method prior to adoption of the single-sales-factor method;

o volume of sales;

o taxable income;

o the book value of plant, land, and equipment;

o net capital investment;

o net assets;

o "capacity utilization"; and

o "debts, itemized by the following categories: (1) loans; and (2) mortgages."

In addition, defense corporations will be required to report the number of contracts with the armed forces of the United States or a foreign government for which a bid was submitted, awarded, or lost during the taxable year, and the number of such contracts that were terminated during the taxable year.

The statutory list is a curious one. Some of the listed items, such as volume of sales and taxable income, are already reported on any Massachusetts tax return. Others, such as "capacity utilization," are not terms of art known to the author, and may be equally meaningless to the companies required to report them. In any case, in the real world of tax return preparation, these new reporting rules - - especially the requirement to compute a company's tax liability under both the old and new apportionment formulas -- will not be met with enthusiasm. In all likelihood, they were not opposed during the legislative debate because legislators would have been unsympathetic in the extreme to complaints about filing burdens in view of the magnitude of the tax break they were enacting. For out-of-state manufacturers who will pay a higher tax to Massachusetts under the single-sales-factor regime, and who played no part in the legislative debate, they will be considered salt in the wound of single-factor apportionment.

Treatment of Service Companies

The single-sales-factor bill as enacted makes no changes in the apportionment rules that apply to service companies. These companies will continue to use a three-factor formula under which sales are double-weighted.

Gov. Weld's tax proposal, of which the single-sales-factor approach was the centerpiece, would have extended it to all corporations.

With respect to corporations providing portfolio management and other services to regulated investment companies, it would have sourced sales in proportion to the mutual fund shareholder base in the state. This is an approach that has been adopted in many of the states that compete with Massachusetts for the mutual fund business. It may yet be adopted by the DOR by regulation, under the "special industry" apportionment rules authorized by General Laws Chapter 63, section 38(j).

With respect to other service companies, the Weld bill may not have made much of a difference in any case, without significant technical changes. The bill applied a single-sales-factor rule to such companies, but made no change in the way the factor is computed with respect to services.

While manufacturers generally source sales to the states where property is shipped, service companies source sales to the state where the preponderance of costs to generate the sales are incurred. Accordingly, for a service company with most of its property and payroll in Massachusetts, adoption of a single-sales-factor approach often would have resulted in the apportionment of 100 percent of the company's income to Massachusetts in any case, absent

a change in the method of sourcing receipts from services.

Conclusion

The adoption of a single-sales-factor approach in Massachusetts represents a radical reform that will provide a real incentive to invest in Massachusetts. Taken together with the enactment of a generous R&E credit, estate tax reform, capital gains tax relief, and the repeal of the sales tax on professional services, it provides dramatic evidence that changes in Massachusetts tax policy have buried the old "Taxachusetts" label at last.

Tax Analysts Information

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Author: Joseph X. Donovan
Institutional Author: Coopers & Lybrand
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Full Text: Massachusetts Revenue Department Examines Effect Of Tax Cut Bills For Defense Contractors.

Citations: Estimates of Raytheon and Related Defense Tax Cut Bills

Summary by taxanalysts

The Massachusetts revenue department's "Estimates of Raytheon and Related Defense Tax Cut Bills" examines the effect of a single- factor apportionment formula for defense contractors; the formula would eliminate the property and payroll factors.

====== SUMMARY ======

The Massachusetts revenue department's "Estimates of Raytheon and Related Defense Tax Cut Bills" examines the effect of a single- factor apportionment formula for defense contractors; the formula would eliminate the property and payroll factors.

====== FULL TEXT ======

MASSACHUSETTS DEPARTMENT OF REVENUE
ESTIMATES OF RAYTHEON AND RELATED DEFENSE TAX CUT BILLS

CHANGE THE INCOME APPORTIONMENT FACTOR TO
INCLUDE SALES ONLY FOR DEFENSE CONTRACTORS

DESCRIPTION:

Present law apportions income by comparing property, payroll and sales in Massachusetts to

those factors everywhere. The sales factor is weighted twice to encourage manufacturing in Massachusetts. Most states use this three-factor formula, but not all states give double weight to the sales factor. This proposal would allow corporations for whom 50% or more of their gross receipts come from defense work to drop the property and payroll factors in calculating their tax. This single factor formula would apply to out-of-state corporations as well as those based in Massachusetts. There might be a constitutional equal protections problem if only defense contractors were permitted to use a single sales factor, while all other corporate taxpayers were required to use the three-factor formula.

ORIGIN:

Raytheon/Senate Docket #1880.

Economic Affairs also requested analysis of an alternative to this proposal which would weight the sales factor 70%, while weighting property and payroll 15%, either for all corporations, or for just manufacturers.

ESTIMATE METHODOLOGY:

To estimate this proposal we first recalculated the tax liabilities for all 1991 corporate returns filed with us. With a computer program, we changed the apportionment formula from its current 50% sales/25% property/25% payroll to 100% sales. Our revenue estimate represents the difference between the tax liability calculated under the current formula and that calculated under the proposed formula.

For all corporations, an elective 100% sales factor would have reduced the 1991 tax liabilities of 12,024 corporations by $169 million; for manufacturers, this option would have reduced the liabilities of 2,052 corporations by $121 million.

For all corporations, the alternative that Economic Affairs asked us to analyze (an elective 70% sales factor) would have reduced the tax liabilities of 12,046 corporations by $100 million; for manufacturers, this option would have reduced the liabilities of 2,054 corporations by $62 million.

Since Raytheon's proposal focuses only on defense contractors who would benefit from a change to 100% sales apportionment, we selected from the results those contractors that would benefit to obtain the range estimate of $30-50 million noted below.

The Raytheon proposal would not raise taxes for any defense company (it allows them to choose between a single sales formula and the current double-weighted sales formula). We assume no company would voluntarily increase its tax burden.

Alternatives that mandated rather than allowed the use of the a 100% or 70% sales factor would cost the state less, but only because some corporations with most of their payroll and property out of state and proportionally higher sales in-state would see their Massachusetts tax liabilities rise.

For all corporations, a mandated 100% sales factor in 1991 would have provided the same

$169 million tax cut for about 12,000 corporations as an elective 100% sales factor while imposing a $70 million tax increase on about 11,000 corporations. A mandated 70% sales factor would have provided the same $100 million tax cut for 12,000 corporations as an elective 70% sales factor while imposing a $50 million tax increase on about 11,000 corporations.

For manufacturers, a mandated 100% sales factor in 1991 would have provided the same $121 million tax cut for about 2,000 corporations as an elective 100% sales factor while imposing a $40 million tax increase on about 2,000 corporations. A mandated 70% sales factor would have provided the same $60 million tax cut for 2,000 corporations as an elective 70% sales factor while imposing a $20 million tax increase on about 2,000 corporations.

STATIC REVENUE COST:

$30 - 50 million per year.

CONFIDENCE LEVEL:

We have a high degree of confidence in the data, methodology and programming that underlie the estimates for all corporations and manufacturers. However, our determination of the individual defense corporations who would be eligible to take advantage of the Raytheon proposal is imprecise: no data are available at the finn level on percentage of business that is defense-related. While the revenue calculations we identify above are based on 1991 data, it would be inappropriate to attempt to "age" these figures for inflation: both corporate receipts and costs are affected by market- and firm-specific inflationary pressures that, on a net basis, may raise or lower corporate income. In general, corporate profit -- and thus corporate tax -- is highly volatile. Because circumstances for individual companies can change rapidly, yielding very different levels of profit and apportionment, all analyses of corporate tax liability carry a significant degree of uncertainty.

SINGLE FACTOR APPORTIONMENT BASED ON SALES
(All dollar amounts in millions)

	Across All Corporations	Manufacturing Corporations
REVENUE IMPACT	$ (97.4)	$ (83.9)
WINNERS/LOSERS		
Number Reporting:		
Increased Liability	11,314	2,216
Decreased Liability	12,024	2,052
No Change in Liability	97,267	9,254
Dollar Change:		

Increased Liability	$ 71.8	$ 37.5
Decreased Liability	$ (169.3)	$ (121.4)
No Change in Liability	$ -	$ -

70%-15%-15% WEIGHTING SCHEME
(All dollar amounts in millions)

	Across All Corporations	Manufacturing Corporations
REVENUE IMPACT	$ (49.6)	$ (41.9)
WINNERS/LOSERS		
Number Reporting:		
Increased Liability	11,219	2,198
Decreased Liability	12,046	2,054
No Change in Liability	92,175	8,957
Dollar Change:		
Increased Liability	$ 50.6	$ 20.2
Decreased Liability	$ (100.3)	$ (62.1)
No Change in Liability	$ -	$ -

CHANGE IN 1991 TAX LIABILITY BY INDUSTRY RESULTING FROM
100% SALES APPORTIONMENT FACTOR

	Manufac-turing	Finance, Insurance and Real Estate	Services	All Other	Total
INCREASED LIABILITY					
Number	2,216	990	2,895	5,213	11,314
Amount ($M)	$38	$11	$5	$18	$72
DECREASED LIABILITY					
Number	2,052	1,233	2,985	5,754	12,024
Amount ($M)	($121)	($11)	($7)	($30)	($169)
NO CHANGE IN LIABILITY					
Number	9,254	12,022	29,902	46,089	97,267
Amount ($M)	$0	$0	$0	$0	$0

NET IMPACT BY INDUSTRY

Number	13,522	14,245	35,782	57,056	120,605
Amount ($M)	(84)	(0)	(2)	(12)	(98)

IMPACT OF SINGLE-FACTOR SALES APPORTIONMENT FACTOR

CURRENT LAW:

Three elements are used to calculate apportionment: the percentage of national payroll in Massachusetts, the percentage of national tangible property in Massachusetts and the percentage of national sales in Massachusetts (double-weighted).

PROPOSED LAW:

Apportionment is based solely on percentage of national sales attributable to Massachusetts.

IMPACT OF CHANGE:

DECREASED LIABILITY

o Corporations with a substantial amount of employment and facilities in Massachusetts that sell nationwide will benefit, especially if sales in Massachusetts represent a small portion of their total sales. This includes large manufacturing corporations and defense contractors.

o In general, domestic corporations will benefit from this proposal.

INCREASED LIABILITY

o Corporations that derive much of their sales from Massachusetts will be hurt by this change. This includes retail and wholesale trade corporations, transportation corporations, corporations in the services sector and financial corporations.

o In general, foreign corporations (based in a different state) will pay more from this change in apportionment.

GENERAL RULE: IF THE PERCENTAGE OF SALES ATTRIBUTABLE TO MASSACHUSETTS EXCEEDS THE PERCENTAGE OF PAYROLL AND PROPERTY ATTRIBUTED TO MASSACHUSETTS, THEN THE SINGLE-FACTOR APPORTIONMENT METHOD WILL LEAD TO A LARGER APPORTIONMENT FACTOR THAN UNDER CURRENT LAW.

EXAMPLES:

MORE SALES THAN PAYROLL OR PROPERTY IN MASSACHUSETTS

CURRENT LAW IN MASSACHUSETTS

	Pct in Mass.	Weighting Factor	App. Pct for Component
Sales	0.700	2	1.400
Payroll	0.500	1	0.500
Property	0.500	1	0.500

FINAL APPORTIONMENT FACTOR 60.0%

UNDER THE SINGLE-FACTOR SALES SCHEME

	Pct in Mass.	Weighting Factor	App. Pct for Component
Sales	0.700	1	0.700
Payroll	0.500	0	-
Property	0.500	0	-

FINAL APPORTIONMENT FACTOR 70.0%

MORE PAYROLL AND PROPERTY THAN SALES IN MASSACHUSETTS

CURRENT LAW IN MASSACHUSETTS

	Pct in Mass.	Weighting Factor	App. Pct for Component
Sales	0.200	2	0.400
Payroll	0.500	1	0.500
Property	0.500	1	0.500

FINAL APPORTIONMENT FACTOR 35.0%

UNDER THE SINGLE-FACTOR SALES SCHEME

	Pct in Mass.	Weighting Factor	App. Pct for Component
Sales	0.200	1	0.200
Payroll	0.500	0	-
Property	0.500	0	-

FINAL APPORTIONMENT FACTOR 20.0%

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Full Text: Massachusetts Society Of CPAs' Chair Expresses Support For Single-Factor Apportionment Formula.

Citations: Donovan Testimony

Summary by taxanalysts

In testimony to the Joint Committee on Taxation, Joseph X. Donovan, chair of the Massachusetts Society of Certified Public Accountants' State Taxation Committee expresses support for the governor's single-factor apportionment proposal.

====== SUMMARY ======

In testimony to the Joint Committee on Taxation, Joseph X. Donovan, chair of the Massachusetts Society of Certified Public Accountants' State Taxation Committee expresses support for the governor's single-factor apportionment proposal.

====== FULL TEXT ======

Testimony of Joseph X. Donovan on Behalf of
Massachusetts Society of Certified Public
Accountants in Support of Adoption of
A Single-Factor Apportionment Formula

Joint Committee on Taxation

October 5, 1995

Thank you Chairman Walsh, Chairman Brett, and members of the Committee. My name is Joe

Donoran. I am the Director of the Boston-office Multistate Tax Services practice of Coopers & Lybrand and the Chairman of the State Taxation Committee of the Massachusetts Society of Certified Public Accountants.

I am here today to testify in support of one element of several pieces of legislation that are before the Committee, including Senate No. 2033 and House No. 5429 -- the adoption of a so-called "single sales factor" method of sourcing the income of corporations to Massachusetts. The Society believes that the adoption of such a method would represent good tax policy, because it will encourage the expansion of business activity in the Commonwealth.

Under current law, if a corporation chooses to add plant and equipment in Massachusetts, but the geographic distribution of its customer base stays the same, its Massachusetts tax bill goes up, because its income is sourced to the state in part on the basis of the proportion of its overall property and payroll that is in the Commonwealth. Under a single sales factor system, a corporation that added plant and equipment in Massachusetts would neither raise nor lower its Massachusetts tax bill. On the other hand, its tax bill in most other states, which use the same three-factor system that Massachusetts now uses, would go down.

I am not an economist and am not competent to address the tax cost to the Commonwealth of adoption of single sales factor method. I do know, however, that under such a system a major part of the tax savings for Massachusetts-based companies would be borne by other states, and that non-Massachusetts companies whose tax bills would go up would be able to lessen or eliminate this effect by investing in Massachusetts jobs and property. I can also speak to the extremely aggressive measures that other states are taking to draw in new business. As the recent report of the Massachusetts Taxpayers Foundation points out, Massachusetts remains a relatively high tax cost state for corporations. Adoption of the single sales formula would create a strong incentive to invest in Massachusetts, at a cost that would be exported in large part to competing industrial states.

Thank you.

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